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Politics this week

Apr 29th 2004
From The Economist print edition

What ceasefire?

AFP

Despite a proclaimed ceasefire, fierce fighting continued in Fallujah, an **Iraqi** city to the west of Baghdad, where some 2,000 Sunni rebels still defy the Americans. In the south, several hundred followers of a rebel Shia firebrand cleric, Muqtada al-Sadr, remained holed up in the Shias' holiest city, Najaf.

See article

Lakhdar Brahimi, the UN secretary-general's special envoy to Iraq, said he hoped that by the end of May he would have chosen an interim government to run Iraq, in partnership with the Americans, until a general election due in January.

See article

At least four people were killed in a district of Damascus, **Syria's** capital, close to the British embassy and a former UN building, when rebels apparently exchanged fire with security forces. It was unclear who the gunmen were or what they had been trying to do.

See article

Jordan's government said that a chemical attack it foiled two weeks ago against the headquarters of the country's intelligence service could have killed 80,000 people. Al-Qaeda has been accused of planning the attack.

The UN Security Council unanimously passed a resolution calling on countries to criminalise the possession, manufacture and trafficking of weapons of mass destruction and the materials to make them, in particular for **terrorist purposes**. A new UN committee will oversee implementation.

Rwandan troops re-entered **Congo** in violation of a peace agreement, UN peacekeepers said. Rwanda denied it.

See article

Thabo Mbeki, **South Africa's** president, appointed a new cabinet, surprising many by keeping on his deputy, Jacob Zuma, despite Mr Zuma's being investigated for alleged corruption.

See article

Zimbabwe's president, Robert Mugabe, got a standing ovation at President Mbeki's inauguration. Back at home, Mr Mugabe's new finance minister, Christopher Kuruneri, was charged with corruption.

In favour of choice

AFP

Around 1m people demonstrated in favour of **abortion rights** in Washington, DC, the largest such rally in America for over a decade. Meanwhile, a senior Vatican official said that Catholic pro-abortion politicians

were “not fit” to receive communion. (John Kerry is Catholic and pro-abortion.)

See article

Arlen Specter, a moderate Republican senator, fended off a strong challenge from a conservative congressman in **Pennsylvania's** primary election. Had Mr Specter lost to Pat Toomey, the Republicans' majority in the Senate would have been in danger.

Justices of the peace in **Massachusetts** were told to resign if they were unwilling to conduct same-sex marriages, which become legal in the state on May 17th. Mitt Romney, the Republican governor and opponent of gay marriage, said the law must be complied with, even if individual judges have strong feelings against it.

See article

The **Supreme Court** heard two cases with broad implications for executive powers. The first was an appeal involving public access to documents collected for Dick Cheney's energy task force, which the vice-president's office argued could compromise future advice given to the White House. The other case determines whether the government has the right to detain two American citizens, both suspected terrorists now held in a navy brig as “enemy combatants”, without trial.

A right to rights

Vicente Fox, the president of **Mexico**, announced plans to enshrine human rights in his country's constitution.

Police flooded into the town of Ilave, in **Peru**, after a mob consisting largely of native Indians who had been protesting about corruption lynched the mayor and attacked the police station with petrol bombs.

Three Irish men who had been accused of training Marxist rebels in **Colombia** to build bombs were acquitted. Colombian prosecutors had alleged that the three were members of the Irish Republican Army. They were found guilty of lesser charges.

Contested victory

In **Macedonia**, the pro-western prime minister, Branko Crvenkovski, declared victory in presidential elections. He defeated a centre-right opponent from a nationalist party which alleged that the poll was fraudulent and should be annulled.

A furious row broke out in **Spain** after the interior minister in the new socialist government, José Antonio Alonso, accused his predecessor of failing to heed warnings that a terrorist attack was imminent, during the run-up to the March 11th train bombings that killed 191 people.

A Spanish judge, Baltasar Garzon, broadened charges against a **Moroccan** fugitive, Amer Azizi, to include indirect responsibility for the terrorist attacks on the United States on September 11th 2001.

Romano Prodi, the president of the European Commission, said he was optimistic that EU leaders would be able to agree on a constitution at their June summit—in part because of new-found solidarity in the face of terrorism. But he was gloomy about the outcome of a referendum on the constitution to be held in Britain.

See article

Slovakia faced the prospect of entering the EU without a majority government after the country's ruling parties failed to resolve their differences.

Gang warfare

AFP

More than 100 people died after **Thailand's** authorities responded forcefully to a co-ordinated series of attacks by machete-wielding gangs in the south of the country.

See article

Foreign aid at last started to arrive in **North Korea**, after a huge explosion at a railway station killed at least 160 people on April 22nd. Meanwhile, “working group” talks that are part of the effort to rid North Korea of its nuclear programme were set to begin on May 12th in Beijing.

See article

China said it would not allow any extension of democracy in **Hong Kong** in elections scheduled for 2007 and 2008. China promised eventually to allow direct election of the territory's leader and legislature but didn't say when.

See article

Pakistan announced plans to reduce the size of its army by 50,000 soldiers, the first cut in its 57-year history.

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Business this week

Apr 29th 2004
From The Economist print edition

Friendlier times for Walt Disney

Comcast, America's biggest cable operator, withdrew its $66 billion hostile bid for **Walt Disney**. Comcast cited a lack of interest on the part of Disney's board for a tie-up.

See article

Nortel Networks, a leading telecoms-equipment firm, fired its chief executive, Frank Dunn, and two top managers after it revealed that accounting errors could lead to a 50% reduction in last year's profits. Nortel's shares plummeted.

See article

Computer Associates restated $2.2 billion in sales for the fiscal year 2000-01 after an internal probe into the software firm's accounting practices. A federal investigation of the company continues.

Global Crossing's shares plunged after the Bermuda-based telecoms firm said it would restate its profits for 2003, review its 2002 results and delay reporting this year. It admitted understating access charges to other phone companies.

Healthy profits

McDonald's reported supersized profits a week after the sudden death of its chief executive, Jim Cantalupo. The fast-food giant made $512m in the latest quarter, 56% more than a year ago, endorsing Mr Cantalupo's strategy of introducing a healthier menu.

Aventis succumbed to the advances of **Sanofi-Synthélabo**, a rival French drug company, after months of battling against a hostile takeover. It was won over with an improved offer of *euro*55 billion ($65 billion).

Boeing took its first order for its 7E7 Dreamliner—50 planes from All Nippon Airways—guaranteeing the launch of its new mid-sized jet. The Japanese carrier is likely to get a substantial discount on the $6 billion list price of the aircraft.

TXU agreed to sell its Australian operations to **Singapore Power** for some $3.7 billion and a gas pipeline to **Energy Transfer Partners** for $502m. It said that buyers were ready to pay over $1.8 billion for its Texas gas utility. The Texas-based energy firm will use the cash to pay off debt.

Out of the driving seat

Mitsubishi Motors' troubles worsened. Rolf Eckrodt stepped down as the firm's boss days after DaimlerChrysler, which holds a controlling interest in the loss-making Japanese carmaker, refused to provide a ¥250 billion ($2.3 billion) cash injection.

See article

Honda Motor said that operating profits for the year to March 2004 fell by 17% compared with a year

ago to ¥600 billion ($5.3 billion). Meanwhile, **Nissan's** operating profit grew by 12% to a record ¥825 billion.

Leaving present

Emilio Botín, chairman of **Banco Santander Central Hispano**, and two former executives were ordered to stand trial for the misuse of bank funds over a *euro*164m ($145m) severance package given to the pair. They left BSCH some time after the merger in 1999 of Banco Central Hispano, which they ran, and Banco Santander. The bank denies any wrongdoing.

See article

Janus Capital agreed to cut its fees by $125m, pay a $50m fine and hand $50m to investors to settle allegations of improper trading of mutual funds. **Amvescap**, another American fund manager, inadvertently sent an e-mail to British investors suggesting that it expects a fine of $300m to settle similar charges.

Eliot Spitzer, the scourge of America's financial institutions, found a new target. New York's attorney-general issued subpoenas demanding information on payments to brokers by 12 big insurance companies.

See article

Some **Chinese banks** said that they had been told to stop lending, as the country's authorities apparently tried to cool the economy. The authorities denied issuing such instructions.

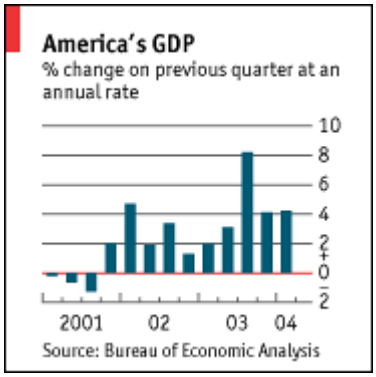
Iraq made efforts to rebuild its shattered financial system by granting three foreign banks—**HSBC**, **Standard Chartered** and **National Bank of Kuwait**—permission to operate in the country. The governor of Iraq's central bank also said that the limit of six foreign banks operating in the country would be lifted.

The cotton club

In an interim ruling, the WTO sided with Brazil in finding that America's huge subsidies to its **cotton** producers violated its rules. Brazil claims that America paid $4 billion in subsidies in 2001 and 2002 for a crop worth just $3 billion. America expressed “serious concerns” and promised to appeal if need be.

See article

America enjoyed another quarter of strong economic growth. Its GDP expanded by 4.2% at an annual rate in the first three months of the year compared with 4.1% in the previous quarter, only slightly less than expected. This left output 4.9% higher than a year earlier.



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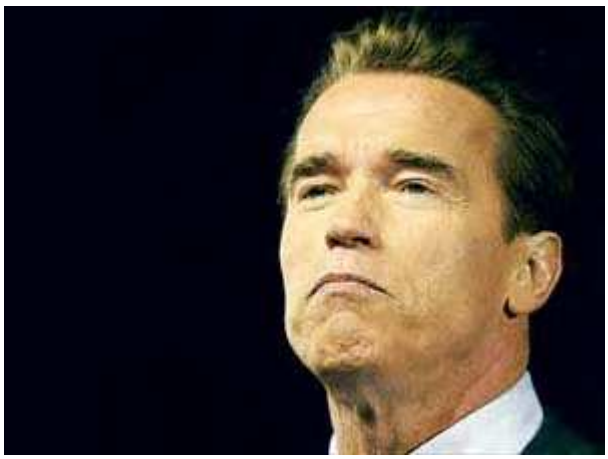
American politics

Is California back?

Apr 29th 2004
From The Economist print edition

Reuters



Arnold Schwarzenegger has done well; but if the Golden State is to recover its lustre, he needs to do more

Get article background

WHAT a short, strange and surprisingly pleasurable trip it's been. Back in October, many outsiders—not for the first time—voiced doubts about the sanity of the inhabitants of the world's sixth-largest economy when Californians decided to oust Gray Davis, the governor they had re-elected comfortably in November 2002, and replace him with an untested actor with a colourful past. Six months into his term, the idea of Governor Arnold Schwarzenegger no longer seems so weird.

In short order, the Gubernator has rammed through two ballot initiatives that have helped bundle the state's accumulated budget debts into a $15 billion bond issue, pushed through a reform of the hated workers' compensation insurance scheme, and carefully sidestepped a row on gay marriage by announcing that such unions are against state law, whilst making it plain that he, himself, does not care if that law is changed. By sticking to the centre, Mr Schwarzenegger has not only persuaded extremists on both sides to stop feuding, but has also rekindled a tolerant, Reaganesque brand of western conservatism. Pro-choice Arnold is likely to play a starring role at the Republican convention this summer, as George Bush tries to de-Dixify his party to lure in independent voters.

Is California really that simple to fix? Alas not. The doubts begin with Mr Schwarzenegger himself. Although he has worked wonders in a mere few months, he has had the political winds behind him. For all his popularity, he is still untested in a hostile press conference, let alone a partisan dogfight, something he may encounter this month as he tries to get a budget deal for next year. But the main reason why Californians should keep the Napa Valley Brut Rosé on ice is because their state is in a worse pickle than they realise.

Oh, California

There is no shortage of reasons to be optimistic about the Golden State. As our survey of California in this issue makes clear, the state boasts a more futuristic array of businesses than any other part of the world. Where else would you find a firm like Google, founded only six years ago but now supposedly worth $25 billion (see article)? As for demography, while most of the developed world gets ever greyer

and more decrepit, California, sustained by immigrants and a high birth rate, will look ever more youthful.

Yet these opportunities also bring challenges—ones that the state is flunking. The Googles of tomorrow need infrastructure—things like roads, energy, water and educated workers, all of which the state has been negligent in providing. On the other side of the ledger, it has been all too diligent in providing regulation, layer upon layer of red tape, ensuring that California is a far costlier place to do business than its rivals. Increasingly, the state has to rely on its intangible advantages—the “clustering effects” of Silicon Valley and Hollywood, for instance. But other places are learning how to copy these things. Already you can spell out an alphabet of passable Silicon imitators (Austin, Bangalore, Cambridge, Dallas...).

When it comes to all those new people, California seems in even bigger trouble. *Pace* the nativists, the state is not about to become a Spanish-speaking province of Mexico: Latinos are inter-marrying and speaking English in much the same way as other immigrants did. But they are being given little help by an education system that is caught between white taxpayers, who have refused to build enough new schools, and the teachers' unions who have blocked structural reform.

Tragicomedy in Sacramento

There is a common theme to all this: poor government. While California's private sector is the envy of the world, its public sector is a tragicomedy—a mess of overlapping counties, cities and special districts, all of wildly different sizes, capped by a deeply dysfunctional, gerrymandered (and thus unrepresentative) legislature. It is a system where nobody is ever at fault, and nobody knows who pays for anything. Unsurprisingly, most Californians opt out—either by not voting or by seceding from the state in private communities.

Some of these things can be put down to years of neglect: California has made no serious attempt to rethink its government for a century. But the state's problems also stem from the one area of government where it has been a pioneer: direct democracy. Ever since the passing of the tax-cutting Proposition 13 in 1978, ballot initiatives have spiralled out of control. They have helped remove up to three-quarters of the budget from the governor's and legislature's remit; they account for many of the weirder contortions in the state's financing; they confuse already perplexed voters; and they have become the main weapon of the lobbyists they were designed to check.

Now, in the best Hollywood tradition, comes the prospect of a happy ending. Somehow, the tragicomedy of California politics has thrown up a suitably improbable *deus ex machina*—an erstwhile cyborg with an Austrian accent. Does he have the nerve? It is all too possible to imagine Mr Schwarzenegger chalking up a couple more victories—an energy deal for instance—and then betting on the recovering economy hiding the budgetary woes. But if he stops there, he will merely have postponed California's judgment day.

An even bolder Mr Schwarzenegger would try to use his extraordinary mandate to reorganise the state—to change the shape of the legislature, to give parents more control over schools, to abolish layers of overlapping government and even to set limits to the initiative process which spawned him. This makes a daunting list—until you consider two things. The first is the impressive, recurrent power of reinvention of California's private sector. The second is the alternative to reform.

Even a place as blessed with natural advantages as the Golden State cannot survive rotten government. As our survey points out, a century ago California competed for immigrants with another young country that was then also the sixth-largest economy in the world. Argentina's promise was duly ruined by its politicians. Mr Schwarzenegger, if he can show the necessary decisiveness, represents California's best chance of clinging on to its dream.

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EU enlargement

Something to celebrate

Apr 29th 2004
From The Economist print edition

What the new members bring to the club

IT IS easy to overlook the significance of a much-trailed event. The expansion of the European Union to take in ten new members, mostly from central Europe, has been looming for so long that, now that it is really happening, on May 1st, it seems almost banal. Yet this is a momentous event in Europe's history: the logical culmination of the tearing down of the Iron Curtain in 1989, making a long-divided continent properly whole again.

Plenty of celebrations mark the occasion. Yet the mood in existing member countries is strikingly glum (see article). European leaders have done little to persuade their electorates of the case for enlarging the EU, so public opinion is mostly hostile. Indeed, far from welcoming the people of these mostly ex-communist countries into the club, the present members have been busy trying to keep them away.

Scare stories about millions of work-seeking migrants (or, contradictorily, work-shy benefit-scroungers) have led most governments to throw up barriers to the free flow of these new EU citizens for at least two years. The Union's paymasters want to hold down budget transfers to the new members, sternly telling them not to expect the generosity shown in the past to Spain or Ireland. And plenty of politicians have attacked supposedly “unfair” competition from the new countries, for example their dastardly habit of paying lower wages or collecting fewer taxes.

This churlishness spectacularly misses the two key benefits of this EU expansion. The first is that it helps countries that, through an accident of geography, suffered for years under the communist yoke. The main point of the exercise ought, indeed, to be to bring trade, jobs and higher living standards to these places, most of them a lot poorer than previous entrants to the European club. That cannot be done without affecting existing members, nor without some cost.

The second benefit is less obvious, but may prove still more important: it is what the new members bring to the club. The continent is undergoing one of its periodic bouts of sclerosis. Growth is sluggish, especially in the euro heartland. Unemployment is stubbornly high. Half-hearted attempts to reform rigid labour markets, generous pensions and bloated welfare systems have run into voters' hostility. Most EU companies are failing to compete effectively with their American or Asian equivalents. There is widespread disillusion with Europe's governments, and with the Union itself.

Some might even ask if the new countries are wise to be joining such a troubled club. Fortunately, their arrival should change it for the better. Their economies are relatively small, but all are growing much

faster than existing members'. That means bigger and more dynamic markets for Europe's companies. And the lower wages, benefits and taxes of the new countries are also good, not bad, for Europe. As with all competition, they offer a powerful stimulus to existing members to renew efforts to cut costs, trim benefits and reform economies.

Most of the new entrants also bring with them healthy attitudes to the European project. Having worked so hard to escape the deadening grip of the old Soviet Union, few want to replace it with the irksome nannying of Brussels. In general they favour the nation-state, not the superstate; few are fans of the new EU constitution. They mostly believe in open markets, not state intervention. Indeed, their entry will do much to bolster the EU's liberal economic credentials.

There is of course a danger that the new members could instead ape the mistakes of the old. There are would-be interventionists and regulators in central Europe too. Companies could, as did some in the former East Germany to its cost, learn that it is easier to lobby for subsidies than to search out new markets. When the region's huge numbers of farmers eventually gain full access to the monstrous common agricultural policy, they could turn into a formidable lobby for it.

Yet the new EU countries are surely alive to these risks. They can see how Germany, France and Italy suffer from excessive taxes, intervention and regulation. If they are wise, they will fight the spread of further social and environmental rules from Brussels. They will resist siren calls for tax harmonisation. And they should put off any decision to join the euro as long as possible. In short, they are best-advised to pursue their national interests, not to subsume them beneath some imagined greater European good.

In doing this, they will also push the European Union away from being a monolithic entity and towards being more of a jumble of different groupings. The model the new countries favour is emphatically not that hardy Franco-German perennial, a hard-core Europe that leaves laggards with little option but to follow that pair's chosen integrationist projects and to remain illiberal where that pair oppose change. Instead, like the pragmatic British and other northern Europeans, they favour a more multi-speed and varied Europe.

Turkish delight

All of this, however, leaves one large fly in the ointment: the eastern Mediterranean. Last week, Greek-Cypriot voters angrily threw out the latest UN plan to unite their divided island. As a result, only the southern part of Cyprus is joining the club, and it is saddling the EU with an unwelcome and intractable border dispute (see article).

A full solution to the Cyprus problem is hard to discern now. But it should encompass the opening of negotiations on Turkey's entry into the EU. Turkey did everything it could to deliver a united Cyprus. Turkish-Cypriots, previously against the UN plan, voted overwhelmingly in favour this time. No doubt Turkey's actual EU membership is still far off. But a decision in principle to admit a Muslim country that has both a large and growing population and a growing economy would cement the renewed dynamism that this weekend's eastward enlargement should import into the European Union.

If anything can save the Union from lapsing into tired obsolescence, it is its enlargement to the east and south-east. And that is the biggest reason of all for existing EU members to celebrate their club's expansion this May Day.

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Mobile telecoms

Why phones are replacing cars

Apr 29th 2004
From The Economist print edition

And why this is a good thing

"PARKS beautifully", boasts an advertising hoarding for the XDA II, above a glimpse of its sleek silver lines. "Responsive to every turn", declares another poster. Yet these ads, seen recently in London, are selling not a car, but an advanced kind of mobile phone. Maybe that should not be a surprise. Using automotive imagery to sell a handset makes a lot of sense for, in many respects, mobile phones are replacing cars.

Phones are now the dominant technology with which young people, and urban youth in particular, now define themselves. What sort of phone you carry and how you customise it says a great deal about you, just as the choice of car did for a previous generation. In today's congested cities, you can no longer make a statement by pulling up outside a bar in a particular kind of car. Instead, you make a similar statement by displaying your mobile phone, with its carefully chosen ringtone, screen logo and slip cover. Mobile phones, like cars, are fashion items: in both cases, people buy new ones far more often than is actually necessary. Both are social technologies that bring people together; for teenagers, both act as symbols of independence. And cars and phones alike promote freedom and mobility, with unexpected social consequences.

The design of both cars and phones started off being defined by something that was no longer there. Cars were originally horseless carriages, and early models looked suitably carriage-like; only later did car designers realise that cars could be almost any shape they wanted to make them. Similarly, mobile phones used to look much like the push-button type of fixed-line phones, only without the wire. But now they come in a bewildering range of strange shapes and sizes.

Less visibly, as the structure of the mobile-phone industry changes, it increasingly resembles that of the car industry (see article). Handset-makers, like carmakers, build some models themselves and outsource the design and manufacturing of others. Specialist firms supply particular sub-assemblies in both industries. Outwardly different products are built on a handful of common underlying "platforms" in both industries, to reduce costs. In each case, branding and design are becoming more important as the underlying technology becomes increasingly interchangeable. In phones, as previously happened in cars, established western companies are facing stiff competition from nimbler Asian firms. Small wonder then that Nokia, the world's largest handset-maker, recruited its design chief, Frank Nuovo, from BMW.

That mobile phones are taking on many of the social functions of cars is to be welcomed. While it is a laudable goal that everyone on earth should someday have a mobile phone, cars' ubiquity produces mixed feelings. They are a horribly inefficient mode of transport—why move a ton of metal around in order to transport a few bags of groceries?—and they cause pollution, in the form of particulates and nasty gases. A chirping handset is a much greener form of self-expression than an old banger. It may

irritate but it is safe. In the hands of a drunk driver, a car becomes a deadly weapon. That is not true of a phone (though terrorists recently rigged mobile phones to trigger bombs in Madrid). Despite concern that radiation from phones and masts causes health problems, there is no clear evidence of harm, and similar worries about power lines and computer screens proved unfounded. Less pollution, less traffic, fewer alcohol-related deaths and injuries: the switch from cars to phones cannot happen soon enough.

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American corporate governance

No democracy please, we're shareholders

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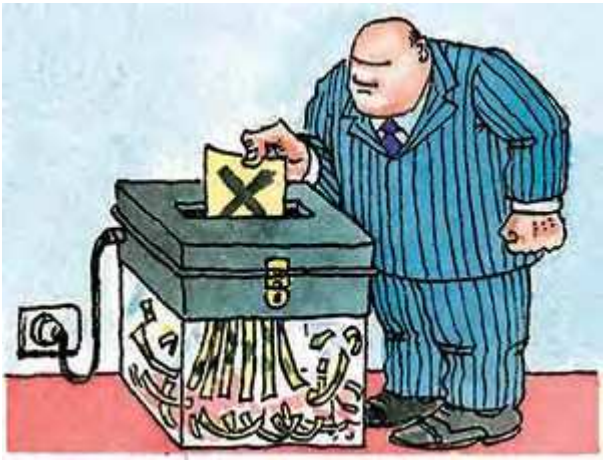
From The Economist print edition



Another proxy season, another gazillion wasted votes

AMERICA is the world's most prominent democracy, and its most successful exponent of shareholder capitalism. But when it comes to shareholder democracy America has barely moved beyond the corporate equivalent of the rotten borough. American firms look democratic. During these past few weeks of the annual “proxy season”, shareholders have been electing board members and voting on resolutions listed on a firm's proxy statement. But given how little difference such votes can make, they might as well not have bothered—which is why shareholders typically vote unthinkingly for what the incumbent board wants, much as citizens of the Soviet Union used to vote for their leaders.

For instance, if a shareholder resolution actually makes it on to the proxy statement—and a board can refuse to put to the vote any resolution it deems to be about “ordinary business” activity—it is typically not binding but “precatory”: advice that the board can take or, more likely, ignore. No wonder most of the resolutions tabled are exercises in political grandstanding on social issues by trade-union shareholders—although, to be fair, a chunk of this year's record crop of resolutions have addressed corporate governance and executive pay.

As for electing directors, there is rarely a genuine contest for a boardroom seat. According to a recent study by Lucian Bebchuk of Harvard Law School, in 1996-2002 there were fewer than two attempts each year to vote out directors of American firms worth over $200m. This is abysmal, but understandable. Under current rules, voting out a director is almost impossible.

In theory, shareholders should be able to elect to the board whomsoever they want. America's reality falls far short of this. Unlike in Britain, shareholders of American firms typically cannot call an extraordinary general meeting to vote in a new board. Indeed, 60% of American firms have staggered boards, which means that only one-third of board seats are up for election each year. Nor is voting for a new director, and against an old one, simply a matter of putting a cross against one name and not the other. The only votes which count are those cast in favour of those names on the corporate proxy—and the firm's board decides which names go on the proxy, and typically only nominates one candidate per seat.

Fair votes for all

So, for all the recent excitement at the Walt Disney Company, where 45% of votes were withheld from

its chief executive, Michael Eisner (see article), even if 99.9% of shareholders had withheld their votes, Mr Eisner would still have been re-elected. To oust him, shareholders would have had to organise and pay for the distribution of a separate proxy carrying a rival slate of candidates, a complex task costing several million dollars. Whichever slate got most votes would win, but the system is so weighted in favour of the official proxy, which the board is free to spend as much as it likes promoting, that contests rarely happen.

All that is why two cheers should be offered to the Securities and Exchange Commission (SEC), which has summoned up enough spirit to propose a small step in the direction of genuine shareholder democracy. It will soon decide whether to implement this proposal—in the face of hysterical opposition from corporate bosses, who can think of nothing worse than being humiliated in a genuine election. Yet the SEC's proposal would not, as bosses fear, turn American firms into models of corporate democracy. The proposal is, if anything, too timid. It would allow shareholders controlling more than 5% of a firm's shares, which they must have held for at least two years, to nominate just two rival candidates—not enough to control the board—on the official proxy. Moreover, they would get this right only in the year after either a majority of shareholders had voted for a resolution demanding it or if at least 35% of votes were withheld from any director on the official proxy.

The SEC should implement this modest rule-change forthwith. It might then consider adopting another quite modest proposal, recently advanced by Ira Millstein, a leading lawyer and corporate-governance reformer, and a rule long observed in more shareholder-friendly places such as Britain: if, by withholding support, shareholders cast more votes against a candidate than in favour, he should not be elected to the board. How daringly democratic.

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Iraq

Mission not yet accomplished

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AFP

America must hold firm in Iraq

NERVES are jangling as the countdown begins. The Americans are supposed to hand over Iraq's government to Iraqis in only two months' time. Meanwhile a ferocious insurgency on two fronts is still far from beaten and might yet spread. Faint hearts are beginning to ask whether the deadline of June 30th can be met, without abandoning the wretched country to even deeper chaos than exists already. Can the current plan, revised hastily several times already, now hold? Or will it have to be redrafted and rescheduled all over again?

The answer is that the deadline can and must be met, and the latest plan adhered to, otherwise America's already bruised authority will be battered again, perhaps irrecoverably. By June 30th, the American proconsul, Paul Bremer, and his leading cohorts should head home and an Iraqi government must then seek to convince the people that gradually, with friendly foreign guns still at their side, they can and will take charge of their own fate. For that to happen, the Americans and their allies must steel their nerves, use guile as well as brawn, and explain with brutal candour to people at home and abroad exactly what it is they are trying to do. Despite the recent mayhem, the game in Iraq is far from lost.

Plainly, the biggest immediate need is to restore law and order, so reconstruction can resume. Equally plainly, that is easier said than done. A fragile stand-off, punctuated by continuing violence, prevails in and around the town of Fallujah, west of Baghdad, where some 2,000 diehard Sunni insurgents, including many from abroad, are dug in, while the Americans tighten a noose around them. In the south, in the Shias' holiest city of Najaf, an equally intransigent and violent core of zealots around Muqtada al-Sadr, a Shia firebrand, seems bent on all-out war against America and the West. Elsewhere, however, a patchy peace more or less prevails.

No time for backsliding

The Americans need to isolate the worst areas, namely Fallujah and Najaf, patiently picking off the insurgents and resisting the temptation to use sledgehammers to crack some admittedly tough nuts. An all-out American assault, risking the deaths of hundreds more civilians, would be rash. The uprisings elsewhere in the past few weeks were stoked not so much by sympathy for the rebels in Fallujah and Najaf as by the spectacle of Iraqi civilians being killed as a result of the Americans' initially heavy-handed tactics. It is vital that they now use patience and precision to snuff out the rebellions—and that they negotiate where possible. To bring more Iraqis on-side, the Americans should invite a wider range of former soldiers, including officers of the old regime, into the new Iraqi forces. Seeing that many foreign

experts have been frightened away, engineers from Saddam Hussein's old army may, for instance, be the only people able to keep electricity plants running as the baking summer approaches.

But this must not mean letting the timetable slip. The Americans have sensibly asked the UN secretary-general's envoy, Lakhdar Brahimi, to select an interim government of technocrats to carry Iraq through the next seven months, until a general election in January, when a truly representative government can take charge. For sure, the interim government will be sharing power with American advisers and above all with American generals. But, again, the Americans must tactfully allow the Iraqis to set the day-to-day agenda, otherwise the government will be undermined by insurgents portraying it as a bunch of stooges. Mr Brahimi is also planning to convene a “big tent” consisting of as wide an array of Iraqis as possible that would appoint a consultative national council. Though Mr Sadr, under indictment for murdering a rival cleric, is beyond the pale, Mr Brahimi should consider bringing some of his followers into the tent, provided they call off their rebellion. He should also encourage local and provincial elections in the next few months in places where peace is fairly secure, to reassure Iraqis that democracy is on the way.

With luck, by the end of this month, a new UN Security Council resolution should endorse this new order, giving the international body the job, among others, of overseeing the elections and encouraging a wider range of helpers, including Indians and Pakistanis and perhaps eventually the sceptical French, to join the coalition and spread the military burden. That, however, will continue to be carried mainly by the Americans themselves. It is no less vital that President Bush send more troops of his own.

Suicide-bombs and other vicious attacks, especially on brave Iraqis who dare to co-operate with America, are sure to continue. The doom-mongers will continue to preach the inevitability of disaster. Iraq's future is indeed precarious. But the slightest sign of hasty moves towards the exit will only precipitate more violence. America and its coalition partners need to hold their nerve and press on with the handover.

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Identity cards

Dangerous data

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From The Economist print edition

Alamy

Databases are more worrying than ID cards

THE notion of the British bulldog nipping at the ankles of the encroaching state is an appealing one, but it does not bear much examination. Britons seem untroubled by a variety of threats to their privacy. They are watched by more CCTV cameras than anywhere else, their genetic material is captured in the world's biggest DNA database and now they are dead keen for the government to introduce identity cards (see article). No wonder David Blunkett, the home secretary and a long-standing advocate of ID cards, sounded confident when he announced on April 26th draft legislation for setting up a national identity register and made it clear that he wants to make cards compulsory for everybody over the age of 16.

ID cards were used in and after the second world war, until, in 1951, Harold Muckle, a police constable, demanded that Clarence Willcock, a north London dry cleaner and a Briton in the bulldog mould, show him his papers. Mr Willcock refused. The case went to the Court of Appeal, and, although Mr Willcock lost, the government was embarrassed enough to abolish ID cards the following year.

Since then, successive governments have looked at reintroducing them, have produced plans to do so, have been attacked by civil libertarians and have given up the idea as not worth the bother. But the world has changed, and this government thinks that the cards' potential usefulness in combating terrorism, illegal immigration and benefit fraud outweighs the costs of introducing them.

A few people—including some cabinet ministers—remain hostile. Patricia Hewitt, trade and industry secretary and former head of the National Council for Civil Liberties, and Jack Straw, the foreign secretary, are said to dislike them. Gordon Brown, the chancellor, has yet to commit himself either way, and is believed to be worried about the cost. Civil liberties groups and newspapers have also been voicing concerns.

But ID cards are the wrong focus for worries about threats to privacy. They have been in use for years in most European countries without leading to any notable abuses. What's more, ID cards are just a small but visible manifestation of a wider and more troubling trend.

The wider trend that needs watching is the computerisation of the state. The government is building huge electronic databases containing information about people's tax payments, employment status, educational record, benefit claims, health, criminal activities and family relationships, not to mention the suspicions that intelligence agencies may have about them. It has access to CCTV film of them. If road-pricing comes in, it will track their movements in cars.

All this is happening not because government cannot resist encroaching on people's privacy, but because it is undergoing an IT revolution which is moving information from cardboard files to computers. This process should make government more efficient, because information can be stored, accessed and manipulated more easily, and databases can be linked.

That's the problem. People want efficient government, but they don't want lots of civil servants nosing around in the intimate details of their lives; nor do they necessarily want the taxman to know about their health. What's more, databases are only as good as the information in them. Last year, the Criminal Records Bureau wrongly identified at least 193 job applicants as having criminal records. If databases talk to each other, such errors will be replicated through the system.

Tell me what you know

The best way to deal with the increasing power that databases give the government is to balance it with commensurate power for citizens. The Data Protection Act goes some way towards doing that, but not far enough: the government still has too much power to withhold information, and there is no clear regime for determining which bits of government have access to information held by other ministries and agencies.

Those who attack the ID plan do so for the right reasons, but they have chosen the wrong target. The real danger lies not in small plastic cards but in huge databases.

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Letters

Apr 29th 2004
From The Economist print edition

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Under new management

SIR – You say that the "orderly" management style of the Bush administration "was usually regarded as an improvement on the improvisatory, free-flowing style of the Clinton White House" ("Something of a quagmire at home", April 17th). I do not know where *The Economist* found this consensus, but it was not here in America where George Bush's detached management style has usually been a source of debate. Until recently, most Americans could not tell the difference between the styles of the two administrations but the knowledgeable have long argued over them. In 2002, John DiIulio accused the Bush White House's rehearsed, hierarchical, uncontested atmosphere of stifling the type of serious policy debate that dominated the Clinton administration and flowed from the president's own style and curiosities.

It is clear the two presidents' management styles are different but to say that one is "usually regarded as an improvement" is misleading.

Michael Slaven
Phoenix, Arizona

Don't go there

SIR – You say that Chinese and South Korean diplomats "never tire of complaining" about Junichiro Koizumi's visits to the Yasukuni shrine ("Ties that grind", April 10th). The Japanese empire raped, pillaged and plundered its way across Asia, with China and Korea bearing the brunt of the assault. If anything, Chinese and Korean diplomats should increase the frequency of their complaints until Japan owns up to its crimes. China's government rightly demands apologies for the rape of Nanking and numerous other atrocities; South Korea's for the abysmal treatment of the "comfort women", forced draft of Koreans into the Japanese army and numerous instances of outright murder.

Many people in both countries will continue to complain until Japan issues a sincere apology, pays suitable indemnities and rewrites its history books to reflect the truth of its imperial aggression. These diplomats are responding to the wishes of their governments and ultimately their citizens for redress—they are not just rattling their sabres.

Christopher Liao
Seoul

God didn't decide

SIR – In your article on southern culture you say "they believed that George Bush was ordained by God to serve as president" ("Left Behind, but not forgotten", April 17th). I live in Oklahoma, on the fringes of the South, attend church every week and do my best to surround myself with good Christians, but I have never heard even the most die-hard conservative say that Mr Bush was chosen by God to lead our nation. Like most others I know, I believe that he is infinitely preferable to Al Gore or John Kerry because he has the *cojones* to confront our enemies, squeamish allies and liberal social-engineering projects, whatever you may say ("Better ways to attack Bush", April 3rd). I would stand adamantly by Mr Bush, if only I were old enough to vote.

Kevin Symcox

Bristow, Oklahoma

Up against Wal-Mart

SIR – Even considering *The Economist's* fervent free-market stance, your article on Wal-Mart is unusually ridiculous ("Learning to love it", April 17th). I am particularly puzzled by the assertion that Wal-Mart is good for its employees. Yes, many of them are marginalised from mainstream workplaces but this does not mean they should be rampantly (or even slightly) abused. Shaving overtime, paying less than a living wage and leaving the night staff locked in regardless of their health and well-being hardly makes for a progressive, dynamic business model.

By listing some of Wal-Mart's ever-multiplying faults, you have at least performed two valuable services: reminding those of us with a conscience why we never shop there and reminding your non-American readers that America's growing discontent with Wal-Mart indicates that they are not quite the ravenous consumer zombies of popular belief.

Timothy Giannuzzi
Calgary

SIR – History is riddled with agents who claimed that their actions were simply a response to existing conditions. In the case of Wal-Mart, the company may be "better" than its competitors at exploiting market trends, but that does not absolve it from responsibility for the consequences of the trends that it helps to promote. What this means for its employees is that they are overworked, underpaid and treated like criminals, while its overseas suppliers work in conditions that would indeed be criminal if they were duplicated in America. Future historians almost always reject this kind of excuse-making, and I suspect that this will happen with Wal-Mart, despite your claims to its innocence.

Matthew Wells
Ottawa

SIR – After living in Germany for a decade, my husband and I relocated to Florida in 1998. We were both reluctant Wal-Mart shoppers at first. However, after the opening of a supercentre near our house, we hardly shop anywhere else. I can get everything under one roof and all at unbeatable prices.

Cynthia Spidell
Odessa, Florida

Privatised army

SIR – Your article on the work of armed private-security firms in Iraq describes the problems of unaccountability, dubious legality and lawlessness as "teething problems" ("Dangerous work", April 10th). They are not. These problems have been endemic with mercenaries for 2,500 years and they are partly why states have retained a monopoly on military force.

Historically, mercenaries have provided poor value for money. As with any bunch of consultants, it's in their commercial interest to prolong their assignment. They rely on the state to train their recruits. A private-sector alternative is likely to place pressure on rates of pay for key service staff. Quality control is often doubtful. I am an overweight, over-aged and out-of-date British ex-officer, but was approached about work as a "project manager" for up to £800 ($1,430) per day, before the latest upsurge in fighting in Iraq. Worse still, the economics of private armies may undermine the peculiar basis under which countries ask soldiers to risk their lives for unquantifiable reasons such as patriotism, loyalty and comradeship. That spell is broken if soldiers dwell on the commercial question: "How much financial reward is it worth to be a hero?"

What will happen if and when the new democratic and free Iraq emerges with 15,000 armed men operating outside legal control and answerable solely to commercial interests? It is a poor legacy to wish on any newly fledged country.

Frank Baldwin
Major (retired)
London

Blown seal

SIR – You report the Canadian government's claim that “the exploding seal population is responsible for a decline in fish stocks” (“World this week, April 17th). Surely this would have the opposite effect?

Jonathan Beale
Jersey

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The future of Europe

A club in need of a new vision

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If the European Union is to thrive after swelling to 25 members, it needs to rediscover its inspiration

MAY DAY is traditionally a workers' holiday. But this year it also marks what should be the biggest day in the 50-year story of the European project. Ten new countries, mostly ex-communist ones from central Europe, are joining the European Union. For them, May 1st used to mean forced jollity and endless military parades. This year, they will be guests of honour at a jamboree attended by all the European heads of government in Dublin (since Ireland holds the rotating EU presidency). What began as the European Coal and Steel Community in 1951, with just six countries—Germany, France, Italy, the Netherlands, Belgium and Luxembourg—will now be an EU of 25 countries, stretching from Portugal to Poland.

As numbers of members go, this is the biggest expansion that the European Union or its predecessors has ever seen. The first came in 1973, when Britain, Denmark and Ireland joined the original six countries in what was by then called the European Economic Community (EEC). In 1981, Greece came in; five years later, in 1986, Spain and Portugal followed. And in 1995 Sweden, Austria and Finland entered what had become known as the EU.

Yet what really matters about the latest enlargement is not its size; in both population and GDP terms, the 1973 enlargement was proportionately a lot bigger (see table). Rather it is, first, that the EU is taking in some former communist countries, including three that were part of the former Soviet Union (German re-unification in 1990 is the closest previous parallel); and, second, that those countries are much poorer than the existing members.

Growing pains?

Enlargement date	Countries joining	Population % addition	GDP (PPP) % addition	GDP per head, entrants as % of existing average
1973	Britain, Denmark, Ireland	33.4	31.9	95.5
1981	Greece	3.7	1.8	48.4
1986	Portugal, Spain	17.8	11.0	62.2
1995	Austria, Finland, Sweden	6.3	6.5	103.6
2004*	Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia	19.6	9.1	46.5

Sources: EIU; Eurostat; IMF; OECD *2003 data

Average GDP per head in the ten new member countries is only 46% of the EU15 average. And although one new member country, Slovenia, is actually richer than the poorest present member, Greece, the poorest new country, Latvia, has a GDP per head of only 36% of the EU15 average. According to estimates by the Economist Intelligence Unit, our sister organisation, even on the rosiest forecasts it will take Poland, say, 59 years to catch up with the EU average of GDP per head. Gaps as big as this dwarf those in previous enlargements, causing headaches in Brussels.

Yet for all the anxiety, this moment is a triumph for the European project. It marks the coming-together of a continent forced apart for 45 years by the Iron Curtain. It is also testimony to the allure of the EU. In nine of the ten countries, membership was approved by referendums, in most cases by huge majorities. And waiting eagerly in the wings are other prospective members. Romania and Bulgaria hope to join in 2007, though realistically it may be later. Croatia will soon be invited to begin talks. Macedonia has recently applied, and other Balkan countries are limbering up. Biggest of all, Turkey hopes later this year to win a date for the start of accession negotiations. Not many clubs can boast of so many eager applicants lining up outside their doors.

Despite this, the mood across the EU is hardly one of elation; it is more of gloom. In part, this is because European voters everywhere are feeling grumpy. Spanish and Greek voters have kicked out their governments this year. The German and French governments have not been alone in suffering humiliating setbacks in local polls. Hitherto popular British and Italian leaders have lost much of their previous glow. And so on.

Slow economic growth is the biggest reason for the voters' sour mood. Over the past five years, growth in Germany, France and Italy has averaged only 1.6%. Unemployment remains high: 9.3% in Germany, 9.4% in France, 11.2% in Spain. Opinion polls consistently show that voters are most worried about jobs, in both the EU15 and the ten new members. The relatively better performance over the same period of the United States is sometimes exaggerated; and some countries in the EU, such as Britain, Finland and Ireland, have done well. But many Europeans believe that they are being left behind.

The European Union as an institution is currently going through a period of quite exceptional unpopularity. Earlier this year, a Eurobarometer poll showed that support for the EU in member countries has fallen sharply to under 50%, well below the levels of over 70% in the early 1990s. Even previous Euro-enthusiasts seem to have been infected. Last November the French and German governments tore up the euro's stability-and-growth-pact rules for fiscal policy with indecent glee. In almost all EU member countries, the tendency to rail against anything that emanates from Brussels is on the rise. Even in such Europhile places as Italy and the Netherlands, hostility to the EU is becoming more overt—and more respectable.

Far from generating more love for the EU in existing member countries, this weekend's enlargement may be aggravating the bad mood. For a long time, ordinary voters were simply unaware that it was happening. As they have woken up to it, however, two big concerns have hit home. One is money: countries that pay heavily into the EU, such as Germany and the Netherlands, fret that they will now have to give more, while those that have been net beneficiaries, such as Spain or Portugal, fear that their cash is going to be siphoned off eastwards.

The second, even more sensitive, issue is migration. Across the EU, the enlargement story that has played most in the newspapers this year has been about the threat of being swamped by immigrants from central and eastern Europe, who will either steal workers' jobs or leech taxpayer-financed benefits (or, confusingly, do both). Already, cities such as London swarm with east European cleaners and builders. It is a sign of the bleak mood about enlargement that most existing members have been quick

to take advantage of transitional rules that allowed them to erect temporary barriers to the free movement of people from the ten new countries—even though, in the long run, most countries in western Europe need more immigrants, not fewer.

The atmosphere of constant bickering that seems to surround the EU does not help. Whether over the budget, the reform of the common agricultural policy or the EU's much-vaunted common foreign policy, discussion in Brussels is characterised more often by bitter dispute than by harmony. The draft EU constitution that is now back on the agenda has exacerbated divisions. Big countries differ with small ones over voting weights and the size of the European Commission. Mostly northern payers-in to the budget fight against mostly southern takers-out. The Franco-German duo that has habitually set the direction for Europe is widely resented, and the notion of adding Britain to form a trilateral group is little more popular (save in Britain). And in foreign policy the “new” and “old” camps in Europe, identified by the American defence secretary, Donald Rumsfeld, during the run-up to the Iraq war, remain easy to spot.

The malaise is quickly spreading to the ten new countries themselves. Despite their eagerness to get into the club, some already show signs of disillusion. Many are proving politically unstable, with coalition governments repeatedly forming and falling, and populist and nationalist parties gaining ground. Last year Poland emerged as the biggest obstacle to the new EU constitution. Last week the famously Eurosceptic Czech president, Vaclav Klaus, gloomily declared that, once in the EU, his country would cease to exist as independent and sovereign.

The Greek-Cypriots' high-handed vote on April 24th to reject the UN plan to unify the island caps it all. Not only does it mean that the EU will now acquire, in the Republic of Cyprus (ie, the Greek-Cypriot half), a new member that imports a disputed border patrolled by UN troops. The republic's government is also joining in a mood of sullen hostility to the EU, which heaped criticism on it for sabotaging the UN plan and which is now keen to do as much as it can to assist the Turkish-Cypriots.

Maybe this discontent with the European Union does not matter. A club that has lasted half a century is surely in no danger of disintegrating. Yet in many ways the EU looks unusually fragile just now. Enlargement from 15 to 25 makes for great uncertainty over how the Union will function. The institutions, especially the European Commission (in effect, the EU's executive), the European Council (the main legislative arm, representing national governments) and the European Parliament (the other legislative arm), are ill-prepared for an influx of so many countries, people and, not least, languages.

The EU's agenda is also quite full. Fraught negotiations on the draft constitution lie ahead, followed in several countries by tricky referendums to approve it (the most difficult of which will most probably be the one promised for Britain by Tony Blair a week ago). Two other highly contentious issues then loom: a decision on whether to open membership negotiations with Turkey, and agreement on the next six-year budget programme.

The combination of a Europe-wide malaise about the EU with such matters of controversy could prove explosive. The British decision to put the new constitution to the vote raises the distinct chance that it will never be ratified. The prospect of Turkish membership, however far off, fills many present members with foreboding. And a budget wrangle with 25 countries could be even more vexatious than previous rows about money. In short, Europeans badly need to take stock and remind themselves what their project is for.

Dreams of the past

It was all much simpler in the early years. In the 1950s and 1960s, the European project stood above all for Franco-German reconciliation. It also represented an economic boom. The end of wartime controls, the gradual abolition of internal tariffs and the shift of labour out of farming and into industry allowed the EEC to outgrow most of the world, including not only European countries outside the club but also the United States. In foreign-policy terms, the EEC fitted into a cold-war framework as a bulwark against the Soviet block, despite the refusal of the French National Assembly to ratify the European Defence Community in 1954, and despite Charles de Gaulle's decision 12 years later to take France out of the military side of NATO.

It was little wonder that Britain and other European countries aspired to join, even though 1973, when Britain eventually did so, marked the start of the first big slowdown in the post-war

European economy. The awkward period of British "renegotiation" of the country's entry terms, followed a few years later by Margaret Thatcher's remark, "I want my money back," brought new setbacks for the European project. But the admission of Greece, Spain and Portugal helped to entrench democracy along Europe's southern rim. And the launch under the commission presidency of Jacques Delors of the 1992 single-market programme helped to restore a new dynamism to the club.

The collapse of communism in central and eastern Europe presented new challenges, but also opportunities. Moves towards a single European currency, passport-free travel, co-operation on justice and home affairs, and a common foreign and security policy were all kicked off by the Maastricht treaty of 1992. This was followed by the start of membership negotiations with the central and eastern European countries themselves.

By comparison with these grand projects, the past half-decade or so has seemed subdued. The actual launch of the single currency in 1999 and the end of the enlargement negotiations in 2002 merely completed work that had been set in hand many years earlier. The popular notion that the European Union is like a bicycle, which must go forward if it is not to fall over, is rather overdone. But it seems plausible to believe that one reason for today's disillusion with the Union is that it no longer has inspiring ambitions.

Towards economic revival

What should the EU do to reinvigorate itself? The most pressing problem is undoubtedly the economy. Four years ago, in Lisbon, European leaders set out the grand-sounding goal of making the EU "the world's most competitive economy" by 2010. But successive reviews of the "Lisbon agenda" have shown depressingly little progress towards that goal. A survey released this week by the World Economic Forum showed once again that most EU members are still a long way from catching up with America.

There are two big reasons for this failure. The first is that, whereas the 1992 single-market programme was largely about removing remaining barriers to trade, Lisbon is mostly about more subtle obstacles, often invoked to protect consumers, in such areas as finance. The bigger difficulty with the Lisbon goals, however, is that they are being blocked at the national, not the European, level. It is national labour and product markets that need liberalisation, just as it is national welfare and pension systems that need reform. The three biggest euro-area economies, Germany, France and Italy, all pay lip-service to the need for change. France is about to unveil plans for reforms in health-care finance. Italy is considering a package of tax cuts. At the end of last year Germany squeaked through most of its so-called Agenda 2010 reforms to pensions, welfare benefits and labour markets.

Yet in all three countries the reforms have been far too modest. And even these have run into stiff resistance from voters. There seems little appetite for taking on the trade unions and other vested interests that are deeply opposed to change. The macroeconomic climate is not helping. Thanks in part to the European Central Bank's tight monetary policy, in part to the fiscal-policy restrictions of the stability pact and in part to their own failure to implement reforms, the biggest European economies have grown only sluggishly in recent years. It is a vicious circle: slow growth means high unemployment, which makes reforms politically harder, which leads to slower growth.

The ten new member countries could be very helpful on this matter. Not only are they growing faster than the existing members, thereby giving the European economy a fillip; after the experience of central planning, they are also, on the whole, more liberal economically. They may not always oppose state intervention, or favour such things as agricultural reform; many still have big state sectors, and there are more farmers in Poland alone than in the whole existing Union. As a new pamphlet from the Centre for European Reform, a think-tank, puts it, the new countries will be in different constellations, sometimes pushing liberal change, sometimes opposing it. There is a risk, too, that EU membership could tilt them towards more regulation. But their general direction is in favour of low taxes, smaller welfare systems and more competition than in many of the existing member states.

In economics, then, EU member countries need to show more ambition. In foreign policy, by contrast,

they should probably have less. The grand idea of a common European foreign and security policy set up, in some minds, partly in rivalry to the United States was not just ahead of its time, as Iraq showed; it was also wrongheaded. The EU needs a common voice, but instead of grandstanding on Iraq or the Middle East, where its influence will always be small, it would do better to focus on what has always been its most successful foreign policy: expanding the club. That now means, above all, finding a way to take in Turkey.

Turkey's eligibility was conceded at the Copenhagen summit 17 months ago. In theory, it is just a matter of fulfilling the criteria needed to begin formal negotiations—which the government of Recep Tayyip Erdogan is working hard to do. That the Turkish-Cypriots voted yes in last weekend's referendum on the UN plan has made it politically very hard for the EU to refuse to open talks. And yet public opinion in many existing countries remains deeply hostile to Turkish membership.

That European smile

Admitting Turkey to the club might not (yet) be part of ordinary Europeans' vision for the EU. But it could become so if it is seen as part of a broader mission to give the expanded EU a new ambition on the global stage. This is to be a beacon and a model: not just of a successful economy, but of a liberal, tolerant, multicultural society. The main target audience lies to the east and south-east of the expanded EU, in Ukraine, Belarus, the western Balkans, the Caucasus and, above all, Russia.

Here the arrival of the ten new member countries could help to give the EU a new role. Their injection of economic dynamism will itself increase the EU's attractiveness as a model. But they also have both more experience of, and more interest in, the former communist and ex-Soviet countries. On April 27th, after long debate, the EU and Russia extended their existing economic and political agreement to the ten new members of the Union. But what might really make a difference would be to get Russia and others, even in the Arab world, to observe an enlarged EU that was rediscovering its earlier successes.

At present, many prefer to see America as a principal model (and rival), because they see in the EU an image of sclerosis and discontent. How much better it would be if they regarded a successful Union as another model (and, as competition is good, another rival). An expanded and revitalised EU that spreads the liberal message around the world would be a fine vision to adopt as this week's celebrations start.

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John Kerry's woes (1)

In search of a message

Apr 29th 2004
From The Economist print edition

Getty

Why merely not being George Bush is probably not a good enough strategy

Get article background

THE past few weeks have been miserable for John Kerry. Not calamitous or terminal. But since he won the Democratic primaries on a wave of Bush-beating acclaim, Mr Kerry has failed to show either the character or policies of which winning campaigns are made. It has been, at the least, a period of lost opportunities.

In early March, Mr Kerry was around five points ahead of George Bush, near or outside the margin of error. By mid-April he was roughly five points behind. A ten-point swing in just over a month is unusually large. What is happening?

A more detailed look at the polls confirms Mr Kerry's problems, though it suggests that direct comparisons with the president may exaggerate his perceived weaknesses. In early March, Mr Kerry was 12 points ahead on the question of handling the economy and 20 points ahead on health care. Now the two men are tied on the economy and Mr Kerry's lead on health care has dropped to six points. More people still think Mr Kerry understands the problems of ordinary people better than Mr Bush, but his advantage has dropped from 17 to ten points. In other words, Mr Kerry's position is not bad, but it is plainly less good than it was.

To be sure, Mr Bush does not have that much to smile about: his job-approval rating has risen—the latest survey from the Pew Research Centre pushes him back up to 48% from the low of 43% it touched in early April—but more people dislike than like his handling of Iraq, Social Security, health, taxes, jobs, the budget deficit and prescription drugs.

But why isn't Mr Kerry doing better? After all, the past few weeks have been among the worst of Mr Bush's presidency. The September 11th commission has aired all manner of accusations, and the news from Iraq has been grim. This week saw yet another embarrassing landmark—the anniversary of Mr Bush's disastrous “Mission Accomplished” speech.

Conventional wisdom in Washington has an explanation for Mr Bush's lead: there must be something

profoundly wrong with Mr Kerry. He was not properly tested in the primaries; he appeals only to dyed-in-the-wool Democrats; the more you know him, the less you like him; he is another Al Gore, a lacklustre Washington insider unable to inspire swing voters.

These fears may yet come true, but there are two more direct explanations for Mr Kerry's dismal performance. First, Mr Bush has been the beneficiary of a rally-round-the-flag response to news from Iraq. Two weeks ago, he gave a televised prime-time press conference. In Washington, he was derided for failing to answer detailed questions. But beyond the Beltway, voters reacted more positively. Mr Bush sounded resolute, said he was determined to stay the course—and they responded. Twice as many now think he “takes a position and sticks with it” than think that of Mr Kerry. Two-thirds see him as a strong leader, while only half say it of his challenger. In other words, the “bad news”, this time, has helped Mr Bush.

The second explanation is the $50m Mr Bush has just spent on television advertising—as much as was bought in the whole of the 2000 election. The TV campaign portrayed Mr Kerry as a flip-flopper and tax-raiser, which seems to have had some effect. By 58% to 29%, voters think a President Kerry would increase taxes.

The chances are that both these effects could be short-lived. Even the Bush campaign cannot spend $50m every month trashing Mr Kerry (it has now scaled back its advertising while Mr Kerry has started a TV blitz of his own). As for Iraq, more bad news could undermine the patriotic rally, replacing it with an erosion of confidence.

So it seems best to view the recent poll movements not as a decisive shift to Mr Bush but an oscillation around the mean. In March, Mr Kerry had an historically unprecedented lead that he could not sustain. Now, Mr Bush has his own version. Incumbents are usually ahead early on because they are known, and their supporters have already made up their minds. But challengers are not known and people who decide at the last minute tend to break for them. In 2000, the lead bounced back and forth throughout the campaign.

If, as seems likely, the dynamic of a close race has not changed, Mr Kerry can take solace from two shifts that are more profound than the horse-race numbers. There has been, first, a long-term increase in the number of people saying the country is on the “wrong track”. In April, 57% said this, compared with an average of 46% in the first four months of 2003, even though job growth spurted in that period.

Second, opinion about Iraq is changing. Though a small majority still thinks war was justified, that compares with three-quarters a year ago. Some 53% want to keep troops in Iraq until a stable government is established, compared with 63% in January. Americans seem schizophrenic, continuing to support the president on a war that they are turning against. If they want to extricate themselves from Iraq by November (and do not think the handover of sovereignty on June 30th counts), then Mr Kerry could benefit hugely.

But this will happen only if he can improve his campaign—and this is where real worries about his performance set in. The past few weeks have seen voters form impressions about Mr Kerry. As he concedes, “a lot of people don't really know who I am,” despite 19 years in the Senate. Those impressions have often been unflattering. Mr Kerry comes across as aloof and longwinded. He lacks the sunny optimism of Bill Clinton or Ronald Reagan.

That weakness can be moderated or hidden: Richard Nixon hardly had a sunny personality. What is more worrying is Mr Kerry's failure to project a coherent message or a reason for running. Whatever one thought about Mr Clinton's Third Way centrism, it represented something new and distinctive in the Democratic Party. Mr Kerry claims to be following in that tradition—a muscular internationalist, a deficit hawk and a middle-class-tax cutter.

Yet as the next article points out, Mr Kerry's economic policy is less Clintonian than it looks. His muscular internationalism is muddied by vagueness on Iraq. His claim not to be “a redistribution Democrat,” as he puts it, is undermined by his rhetoric and by a team of advisers drawn extensively from Mr Gore's populist ranks. The result, as some of his supporters concede, is that he comes across as just a generic Democrat. No one can finish the sentence “I support John Kerry because...” except to say “...he is not George Bush.”

If the election is just a referendum on Mr Bush, none of this may matter. Mr Kerry is raising huge amounts of money—a record $55m in the first quarter—which may be all that is necessary if the

Republicans defeat themselves. But there are big risks to running a message-free campaign. It could depress Democratic turnout. It lets Mr Bush define Mr Kerry. And if he wants to fulfil the Democrats' pledge to “take back the country”, and seize the political initiative, Mr Kerry will need a governing strategy on inauguration day. To do all that, he needs to start imposing what he stands for on the party. That is the opportunity fast disappearing.

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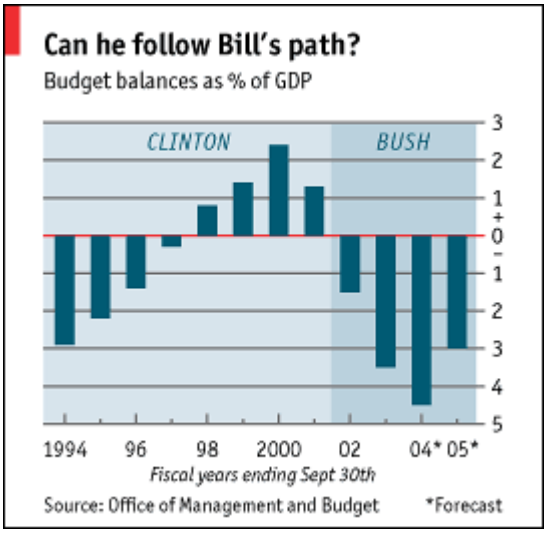
John Kerry's woes (2)

The problem with Kerrynomics

Apr 29th 2004 | WASHINGTON, DC
From The Economist print edition

The challenger's economic ideas are less Clintonian than they look

Get article background



IT HAS become conventional wisdom in Washington, DC, that Kerrynomics is a reincarnation of Clintonomics, the catch-all label for Bill Clinton's brand of business-friendly, fiscally prudent, globally oriented economic policy. Unlike Al Gore, who disastrously dumped this centrism for a more populist tone, John Kerry has embraced Mr Clinton's strategy; once he has removed George Bush's irresponsible tax-cutters, Mr Kerry will bring back the same fiscally prudent grown-ups who ran the economy during the 1990s.

True to this picture, Mr Kerry's economic team is drawn from the Clinton era. His chief economic adviser, Roger Altman, was deputy treasury secretary at the beginning of the Clinton presidency. Gene Sperling, who spent eight years in the Clinton White House, is also prominent. Robert Rubin, Mr Clinton's revered treasury secretary, plays a pivotal, if less public, role. Jason Furman, Mr Kerry's economic- policy director, cut his teeth in the last Democratic administration.

Mr Kerry's policies also carry many of the hallmarks of Clintonomics: a focus on deficit reduction, a willingness to raise taxes on the rich while cutting taxes further down the income scale, a business-friendly tax agenda coupled with a determination to cut corporate welfare, and a penchant for tax credits as a policy tool.

But look carefully, and differences between Kerrynomics and Clintonomics emerge. In a few areas, this is to Mr Kerry's credit. For instance, his plan to help the millions of Americans without health insurance (by expanding existing government health plans for the poor and subsidising employer-based coverage) may be expensive, but many experts judge it more sensible than the Clintons' arrogant attempt to reorganise the whole health-care industry. Too often, however, Kerrynomics, at least at this early stage, seems a pale imitation of Mr Clinton's centrist creed.

Take **trade and manufacturing jobs**. Like Candidate Clinton, Mr Kerry has made the need to create jobs the main focus of his campaign—particularly in the battleground mid-western states he visited again this week. Yet Mr Kerry is much warier of the global economy than Mr Clinton was in 1992.

Though Mr Kerry acknowledged this week that “America must always engage in the global economy”, he made no mention of pushing new trade deals or of the Doha global trade talks. Instead, he focused on the need to reintroduce the “Super 301” process, which gives the White House special responsibility to go after countries with unfair trade barriers. He also wanted to get tougher on China and Japan for their “illegal” currency manipulation. And he noted approvingly that the Clinton administration filed an average of 11 complaints at the WTO each year, compared with only three per year during the Bush term. Where Candidate Clinton spoke with optimism about the promise of the global economy, Mr Kerry, despite his strong pro-trade record in the Senate, sounds defensive.

Times have changed, argue Mr Kerry's advisers. American support for globalisation has eroded over the past decade, while the trade deficit, especially the bilateral one with China, has soared. Compared with the protectionist nonsense that other Democrats were touting during the primaries, Mr Kerry's plans will

do little harm. A Kerry trade policy towards China would look much like Mr Clinton's approach to Japan in the early 1990s: fierce talk and much sabre-rattling. To make progress on trade, according to this logic, you must show you can be tough first.

Well possibly. But it still seems more likely that Mr Kerry has simply chosen political expediency over principle. Interestingly, Mr Bush refused to follow suit this week, throwing out petitions to launch trade investigations into China's currency and workers-rights practices.

In terms of **fiscal rhetoric**, Mr Kerry actually sounds much tougher than Candidate Clinton. In 1992, Mr Clinton focused less on dealing with the deficit than he did on an (expensive) plan to get America working through massive public investment. Mr Kerry instead touts the discipline that Mr Clinton's team became known for.

He has promised to halve the budget deficit in his first term, and to roll back the Bush tax cuts for all who earn more than $200,000 a year. As a sign of his seriousness, he has offered to scale back other campaign priorities, such as a national-service programme. And he has pledged to reinstate spending caps and PAYGO rules, where new tax cuts or spending increases must be paid for.

Look carefully, however, and, on paper at least, Mr Kerry's proposals are not much more prudent than Mr Bush's. Mr Kerry's roll-back of the Bush tax cuts would increase federal revenue by $850 billion over the next decade compared with a scenario where the Bush tax cuts became permanent. But Mr Kerry intends to spend around $850 billion over the same period on his health-care and education plans. Though he wants cuts in “corporate welfare” (an old Democratic chestnut), the overall deficit over the next decade would be scarcely smaller under President Kerry than under President Bush. Contrary to his rhetoric, Mr Kerry's plans do not make deficit-reduction central.

Yet even if Mr Kerry is some way from Mr Clinton in terms of fiscal rectitude, it is unfair to line him up alongside Mr Bush. Not only does the challenger have a different set of priorities (in effect, he swaps lower taxes for the rich for more health spending), but his numbers are more credible than Mr Bush's, whose budget is widely regarded as fiction in Washington. Mr Bush wants to make the existing tax cuts permanent, and would like to cut taxes further. This White House does not see the deficit as a problem, whereas Senator Kerry has a record as a deficit hawk.

Yet Candidate Kerry is not above abandoning sensible policy positions when they are no longer politically expedient. Take **Social Security**. In 1996, Senator Kerry argued that America needed to consider bold options in pensions reform, including raising the retirement age and means-testing pension benefits. Now he rejects that position, claiming that economic growth will fix America's pension problem. “I'm not going to cut Social-Security benefits. I'm not going to extend the retirement age and we're not going to have to raise premiums,” he said recently. No serious economist believes such a blasé approach will work.

Mr Kerry's twin problems in economics—as in the rest of his campaign—are, first, the lack of a compelling message and, second, his desire to be all things to all people. There is no Kerry equivalent of “It's the economy, stupid”, and no centrist vision of America's economic future. Instead, Kerrynomics is a defensive creed, defined only by contrast with Mr Bush's “failed” policies. But as the job market strengthens, that comparison may be harder to sell: fiscal profligacy may matter less than fatter pay-packets. Worse, Mr Kerry's sensible centrist instincts are muted by a need to appeal to the left of his party and by a terror of tackling difficult issues. Kerrynomics, both substantively and politically, is less attractive than it ought to be.

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The electoral week

On the trail

Apr 29th 2004
From The Economist print edition

Calling Dr Freud

"As I was telling my husb...as I was telling President Bush."

Bachelorette Condoleezza Rice's tongue slips during a dinner party. New York magazine, April 26th

Now that's an insult

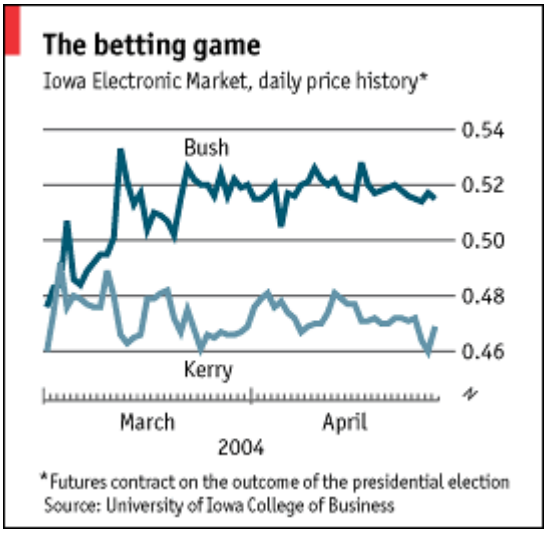
"It could have been worse, Pete could have been identified as John Kerry."

A spokesman for Pete Coors, a Republican Senate candidate in Colorado, on the New York Times's mistaken use of his picture to illustrate a story about a Ku Klux Klan member and murderer. Rocky Mountain News, April 23rd

I vant to be alone

"My most favorite part about being president is making decisions that make the world more free and more peaceful. My least favourite part...is that I can't just walk out the front door of where I live and go for a walk by myself."

President Bush answers a question from 8-year-old Tom Kelly. New York Post, April 23rd



Our kind of Doh

"Look at me. I'm reading *The Economist*. Did you know Indonesia is at a crossroads?"

While experiencing first-class air travel for the first time, Homer Simpson lays out his credentials to succeed Colin Powell. The Simpsons, April 25th

Environmentalism is SO over

"I have no idea why [Mr Kerry] is spending any time on this. I think the polls show it's somewhere beneath dental care in the minds of the public."

Bay Buchanan, sister of Pat, on Earth Day, Inside Politics, CNN, April 22nd

You go, girl

"So I married a younger guy—they say women should. Cradle snatcher! I've always liked babies."

Teresa Heinz Kerry explains the five-year age difference with her husband. Newsweek, May 3rd

Let them eat cake (1)

“Of course you would try to avoid things like lobster and shrimp, you would just find different ways to make it work: a dip rather than a lobster tail, cheese crudités and fruits. We're going to have to be creative.”

A Democratic caterer reacts to the $100-per-head limit on the budget for state cocktail parties during the convention in Boston. Boston Globe, April 23rd

Let them eat cake (2)

“I don't know where John Kerry eats... But I tell you, at the Taste of Texas restaurant—it's this great steakhouse in Houston, Texas—the only foreign leader you meet there is called filet mignon.”

Republican House Majority Leader Tom DeLay, responding to Mr Kerry's comment that you could run into world leaders in restaurants in New York, Washington Times, April 23rd

Hair today

“John Kerry has tons of hair. For balance, he needs a running-mate with a little less hair.”

Barbie Adler, a professional matchmaker from Chicago, chooses a veep. Wall Street Journal, April 26th

Sex bomb

“The more reporters get to see him up close, the more appealing he is.”

Dick Cheney is allowed out of the bunker. US News & World Report, May 3rd

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Crime and punishment

A matter of evidence

Apr 29th 2004 | BOSTON
From The Economist print edition

Does the criminal-justice system work properly in Massachusetts?

AP

Amirault, almost free, still guilty

PROSECUTORS often argue that their cases are foolproof and their evidence incontrovertible. So they did 18 years ago in the trial of Gerald "Tooky" Amirault, accused of heading a molestation ring at a suburban Boston day-care centre. At the time, Massachusetts and the whole nation were gripped by tales of child sexual abuse, and the tiny witnesses in the Amirault case offered details that were lurid and bizarre: assaults by clowns, tortured animals, children tied naked to trees. Mr Amirault, who was 32, was convicted of rape and assault and got 30 to 40 years.

This week he is due to be freed, granted parole as soon as he was eligible. Good prison behaviour persuaded the local prosecutor not to try to keep him detained as a "sexually dangerous person". But a string of prominent supporters have long fought for Mr Amirault's release on more fundamental grounds, saying he was wrongfully convicted. His young accusers, they argue, were subjected to suggestive interviewing techniques that have since been discredited, and were browbeaten by zealous prosecutors and panicky parents. And his story, they say, is proof that the criminal justice system can fail, punishing a man by mistake.

All this is quite a different view of crime and punishment from the one Governor Mitt Romney has been taking, as he fights to reinstate the death penalty in Massachusetts. A chief objection from death-penalty opponents is that while the system is fallible, the punishment is irreversible; but Mr Romney rejects that argument, citing advances in science and the use of DNA evidence that is far more reliable than witness testimony. His aides have been touting an upcoming report, by a panel of forensic experts, which they say will show how Massachusetts courts can produce airtight convictions. Mr Romney hopes he can convince the legislature to support capital punishment for terrorism and what he calls the "most heinous" sorts of murders.

If he does so, it would be a substantial political coup. Despite a decade of Republican governors, Massachusetts remains one of 12 states without the death penalty. Its junior senator, John Kerry, the presumptive Democratic presidential nominee, opposes capital punishment except for convicted terrorists. Mr Romney campaigned, two years ago, on restoring the death penalty, calling his opponent's opposition "the height of naïveté". His current effort is part of a series of tough-on-criminals measures, including a recently signed bill that will make it easier to keep sexual predators locked up.

But his death-penalty push also comes at a convenient time. As a prominent supporter of George Bush, Mr Romney certainly doesn't mind drawing a contrast between the Democrats' and Republicans' stance. Indeed, it is hard to view any political decision about crime outside the context of current events. When a death-penalty bill came within one vote of passing the Massachusetts House of Representatives in 1997, it was largely fuelled by outrage over the murder of a ten-year-old boy. A similar confluence of events worked against Mr Amirault three years ago, when the state parole board recommended that his sentence be commuted to the years he had already served. At the time, news of alleged child molestations by Catholic priests was reaching fever pitch, and the acting governor, Jane Swift, refused to commute the sentence.

Mr Romney has been spared a similar decision. The board last year chose not to recommend another commutation, saying Mr Amirault should instead apply for parole, which does not require a governor's approval. Now Mr Amirault's supporters are ebullient, though his lawyer, James Sultan, raises one half-

regret: there's no chance of re-trying the case, he says, and clearing his client's name for good.

Mr Sultan notes that many people have approached him to express the sort of sympathy that convicted sex offenders don't usually get. Yet many others continue to believe that Mr Amirault committed the crimes for which he has served time. Martha Coakley, the district attorney in the case, stresses that parole is not exoneration. What really happened inside the Fells Acres Day Care Centre will probably remain unknown—one of those mysteries Mr Romney thinks the criminal justice system will be able, some day, to avoid.

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Historical documents

Whose Bill of Rights, anyway?

Apr 29th 2004
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A noble piece of paper attracts a swarm of lawyers

THE tenth amendment to the United States Constitution—the last amendment of the Bill of Rights—grants to the states all powers not given to the federal government. Under this amendment, the states are equal; Virginia law cannot trump Texas law, for instance. But that equality has proved vexing for one particular copy of the Bill of Rights itself.

Fourteen Bills of Rights were drafted in 1789: the federal government's copy, which now sits in the National Archives in Washington, DC, and one for each of the 13 original states. North Carolina's copy, however, went missing during the civil war. A Union soldier supposedly took it from the state capitol building in 1865 to Tippecanoe, Ohio.

For years, the document was a mere rumour. Then, in 2003, the FBI heard that Wayne Pratt, a well-known antiques dealer from Connecticut, was trying to sell it to the National Constitution Centre in Philadelphia for $4m. The state of North Carolina obtained a seizure warrant—and in March last year, the FBI set up a sting operation that “caught” Mr Pratt trying to sell the document. A grand jury was convened to investigate Mr Pratt, but once he relinquished his claim to the document, criminal proceedings stopped—and he agreed to sell the document to North Carolina for $1.

But Mr Pratt, alas, was not the sole owner of the document. He had bought the Bill of Rights in partnership with another man, Robert Matthews, a Connecticut-based businessman who was not threatened with criminal prosecution. Mr Pratt had reportedly told Mr Matthews that the document had been kept by two elderly sisters, whose family had owned it for 130 years.

Now the case is tangled in litigation. The federal district court for North Carolina first ordered the state to return the document to Mr Pratt's lawyer (in whose possession the FBI technically found it). Then it ruled that the document belonged to North Carolina, but Mr Matthews won a restraining order in a Washington, DC, court forbidding Mr Pratt's lawyer from turning the document over to North Carolina. Meanwhile, Mr Matthews is suing Mr Pratt in a Connecticut court, and a group of Tennesseans have also claimed an interest in the Bill of Rights because, when it was ratified, North Carolina included four counties in what is now Tennessee.

On April 19th, Mr Matthews's attorneys filed an appeal in the Fourth Circuit Court in Richmond, Virginia, one of the country's most conservative courts. Meanwhile, Mr Pratt, having pleaded guilty to tax evasion, is helping with a corruption investigation against John Rowland, the governor of Connecticut.

And the Bill of Rights itself? After the sting, United States marshals in North Carolina took possession of the document from the FBI for what was supposed to be brief safe-keeping. They may have it for some time yet.

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Tax-raising Republicans

No longer an oxymoron

Apr 29th 2004 | RICHMOND
From The Economist print edition

Will Virginia set a trend for George Bush's party?

IF THERE is one part of domestic policy that Republicans can normally agree on, it is that raising taxes is a bad idea. But they are also often practical folk—and many states now face huge budget deficits that can only partly be closed by spending cuts. Hence the significance of what happened this week in Virginia.

Virginia is one of the country's more conservative states. Yet the local Republicans—or at least some of them—have just agreed to a $1.3 billion package of higher taxes on retail sales, tobacco and property deals. They blame circumstances beyond their control, such as the dotcom bust, which hurt plenty of companies in Virginia, and the economic aftershocks of September 11th. Even after cutting spending by $6 billion and trimming 5,000 public jobs, the state still faced deficits in the decade ahead.

Higher taxes were also a last resort for Virginia's Democratic governor, Mark Warner. The toothy high-tech millionaire had wooed conservative voters three years ago by promising not to raise taxes. But further reductions in spending threatened to cripple services, including education. Last November Mr Warner reluctantly announced plans for a $1 billion tax hike to mend the state's battered finances.

At first this looked unlikely to get through the solidly Republican legislature. But a funny thing happened on the way to this year's session of the General Assembly: the Republicans self-destructed.

The moderate Republicans who control the Virginia Senate sided with Mr Warner, but urged a tax package four times pricier than his. The conservative Republicans in charge of the House of Delegates resisted higher taxes altogether, saying that the two-year, $59 billion budget could be balanced with more cuts, accounting gimmicks and heftier user fees that critics deride as hidden tax increases.

For much of this year, both sides have refused to budge, forcing the legislature, which usually sits for 60 days, into lengthy overtime. The longer the Republicans did nothing, the more Mr Warner seemed the great compromiser. Polls showed Virginians, despite their traditional hostility to taxes, willing to pay more, especially for schools, public safety and health care. And town meetings across the state, which Republicans boasted would validate their no-new-taxes stance, instead became forums for criticising their inflexibility. After nearly 100 days of inaction, a handful of moderate Republicans in the House rebelled against their anti-tax leaders, setting in motion the deal this week.

This is quite a coup for Mr Warner, who has otherwise achieved little. But it may also have national repercussions for the Republicans. By appearing to be the authors of the tax rise, the Republicans may have made it harder for the party to play the anti-tax card, at least at state level. Meanwhile, the Virginia situation is a reminder of the enduring split within the party between pragmatic business conservatives and populist ideologues, who continue to depict government as a costly, unwieldy and intrusive enemy.

Prominent national anti-tax campaigners, such as Grover Norquist, a close adviser to the Bush White House, are now promising to help challenge the treacherous Virginia legislators in Republican primaries. This week, Arlen Specter, a famously moderate senator from Pennsylvania, only just fended off a primary challenge from a local conservative congressman, Pat Toomey, who received $2m from anti-tax people. Ironically, Mr Specter seems to have been saved by some last-minute campaigning by George Bush, whose tax cuts the senator had criticised as being too big. The White House is desperate to hang on to the Senate—and the centrist Mr Specter looks a better bet in the November general election.

Yet the problem is unlikely to go away. Some 17 states are considering higher taxes, according to the National Conference of State Legislatures. In California, another place hard hit by the dotcom crash,

Arnold Schwarzenegger recently let slip the idea that his anti-tax stance might be wishful thinking. It could be a tough summer for the Republicans.

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A life and choice matter

Apr 29th 2004
From The Economist print edition

The battle over abortion provides some intriguing lessons about American politics

Get article background

YOU have to hand it to the pro-choice movement. Last Sunday's march in Washington, DC, was a triumph. The abortion-rights movement not only succeeded in conjuring up one of the biggest marches in American history, with 1m people crowding on to the mall, a seething mass of deep purple and hot pink. It also succeeded in updating its image a little, recruiting hundreds of thousands of fresh-faced college students to march alongside wrinkled feminist icons such as Gloria Steinem.

But shift your attention from the sheer spectacle of the march to the reason why people were there and the story changes from triumph to retreat. The reason why so many people descended on Washington was that, more than 30 years after *Roe v Wade*, the court decision safeguarding abortion rights, they feel those rights are being curtailed. And the reason why those rights are being curtailed is that the pro-life movement has repeatedly outmanoeuvred the other side. The battle between these two forces is a microcosm of the wider battle between liberalism and conservatism: the conservatives have transformed an apparent lost cause into an agenda-setting battle cry.

A decade ago, pro-lifers were seen as cranks. Pro-life vigilantes murdered abortion doctors, firebombed clinics and threw every insult under the sun at the Clintons, who were busy extending abortion rights. Today the picture is very different. In 2003 a survey of college freshmen by the University of California, Los Angeles, showed that only 55% of them thought that abortions should be legal, down from 67% in 1992. Last November, when George Bush signed a law banning partial-birth abortion, this first federal restriction on abortion for 30 years passed the Senate by a lopsided majority of 64-34.

The most obvious reason for the change is that pro-lifers have captured the political establishment. Republicans control all three branches of the federal government as well as a majority of seats in state legislatures. The party is also much more hostile to abortion than it has ever been before. There are a few pro-choice Republicans left—Arnold Schwarzenegger and Colin Powell, for instance—but their numbers are in sharp decline.

The pro-lifers have also got a lot cannier. You don't need to be all that clever to realise that shooting people in the name of life is a losing strategy, even if you justify it on the grounds that “quite a number

of babies' lives will be saved", as Don Treshman, the leader of Rescue America, once did. That rhetoric is now soft-pedalled. Even though the pro-lifers' long-term goal remains the same—the repeal of *Roe v Wade*—they have attacked by stealth rather than full-frontal assault.

The pro-life movement has shifted the debate from a lofty, widely supported principle (should women have the right to choose?) to much more specific questions. Do women have a right to abort their fetuses in the third trimester? Can an underage girl have an abortion without her parents' consent? Should taxpayers' money be used to finance abortions? These tactics have made the pro-choice people look like extremists: defending partial-birth abortion is a lot harder than defending the principle of choice. The tactics have also allowed state legislatures to impose umpteen restrictions on abortion, such as waiting periods, Medicaid bans and parental-consent laws.

In the meantime, the pro-lifers have tried to change the culture that underpins *Roe v Wade*. George Bush has remarked that he doesn't think that "the culture has changed to the extent that the American people or the Congress would totally ban abortions." But conservatives are still having some success in this slow-motion culture war. Frances Kissling, a long-time pro-choice activist, admits that it is much easier for people to see themselves as "pro-life" than it was a decade ago—thanks to advances in neo-natal care, improvements in sonograms and the increasing popularity of adoption.

All this has required a remarkable combination of patience and opportunism. The pro-life movement has gradually constructed a network of institutions, from James Dobson's Focus on the Family behemoth in Colorado Springs to tiny think-tanks in most state capitals, that keep the anti-abortion fires burning and spot mistakes by their opponents. William Saletan, the author of "Bearing Right: How Conservatives Won the Abortion War" (University of California Press, 2003), describes how the pro-lifers used the pro-choicers' arguments about limiting government intrusion into people's private lives to undermine the case for public subsidies for abortions for the poor.

To the barricades

Yet things are not all going the pro-lifers' way. The number of marchers this weekend is a sign of the roadblock being erected in front of the slowly advancing conservative machine. Indeed, conservatives may yet regret that they have not been stealthy enough and have stirred up opposition that will cost them dear. The marchers were united by a palpable hatred of the Bush administration. ("Abort Bush in the first term", read a typical banner.) Pro-choice groups are already planning a massive voter-turnout campaign for this November's general election.

And this roadblock is being erected at a time when the pro-lifers are still far from their real target. They may have succeeded in changing abortion policy at the margins (particularly the margins inhabited by the poor). But the thing that really upsets them—the constitutional right for women to have abortions—still commands solid support. And, for conservatives, this seems part of a worrying pattern in domestic policy. Right-wingers have succeeded only in implementing the easy part of their ideas (cutting taxes rather than shrinking government, for example) and yet half the nation is nevertheless up in arms. Just imagine the outcry if conservatives start trying to implement the difficult things—like banning abortion completely.

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Panama and its canal

Manifest destiny meets democracy

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From The Economist print edition

Reuters

Panama's canal needs an upgrade. Can its politicians deliver one?

WATCHING their ship inch through the last lock gates of the Panama Canal into the Pacific is grand entertainment for cruise passengers. It also represents good business for the canal, which charges the very biggest liners around $250,000 per passage. But with just two feet to spare on each side, it is a tight squeeze.

With up to 38 big ships passing through it each day, the 90-year-old waterway is now at the edge of its capacity. Still more worryingly for its operators, those locks are too narrow to handle today's biggest container vessels (of a size undreamed of by the canal's engineers), many of them carrying Chinese exports. So Panama is increasingly missing out on some lucrative custom. To survive, the canal needs to grow. Whether it does so will partly be determined by whoever wins Panama's presidential election on May 2nd.

Big is bountiful

In theory, the management of the 80km (50-mile) canal and the election of a new government are unrelated, since Panama's constitution guarantees the autonomy of the Panama Canal Authority (PCA). The PCA has won high praise since the United States' government finally handed over administration of the canal to it in 1999. In practice, the fate of the canal, and those of the country and its government, are inextricably linked. The government is the sole shareholder in the PCA; about one-third of Panama's GDP comes from canal-related revenues. And the current debate about the canal's future will entwine it and the Panamanian government still further.

The PCA has been pondering modernisation schemes for at least a decade. But now, finally, it is on the verge of presenting a “master-plan” for the waterway's future. If, as expected, it proposes a major enlargement of the canal, the overhaul will have to be put to a vote in a referendum.

So one of the first tasks of whoever wins the election, when he takes office in August, will be to sell the plan to the electorate. Can the PCA and Panama's politicians (the latter better known for their money-laundering than for their foresight) between them ensure that their country gets the most vital decision

in the canal's history right? Or will they end up squandering what has been one of the western hemisphere's prime assets?

Until recently, most big boats were built up to a standard “Panamax” size, 106 feet (32 metres) wide and 965 feet long, which just fit through the canal's locks. But new “post-Panamax” ships, up to 150 feet across and 1,200 feet long, are emerging from Asian shipyards. On April 26th, Mitsui OSK Lines, a big Japanese shipping firm, announced that it was investing in another 12 such leviathans, an order worth about $1 billion. Altogether, around 160 such vessels are due to be built over the next few years. Ports around the world are being upgraded to accommodate them.

Commercially, the Panama Canal has little choice: either it expands, or its trade will dry up. The PCA will almost certainly say that its preferred option is a third set of locks even bigger than the two current sets. As well as allowing the canal to handle the vast new ships, that would free up the existing waterways for more traffic, at a cost, some estimates suggest, of around $8 billion. It would be the most important refit since the canal opened.

The plan has not been an issue during the election campaign, which Martín Torrijos, son of the military dictator who negotiated the hand-over of the canal with President Jimmy Carter in the 1970s, is set to win. He has a 20-point lead in the polls over his nearest rival, a former president, Guillermo Endara; Mireya Moscoso, the current president, is widely regarded as weak and ineffectual, and her party's candidate is trailing badly. But politicians on all sides seem to acknowledge, as Ira Rubinoff of the local Smithsonian Institute puts it, that investing in the canal is “the manifest destiny of Panama's geography”.

Yet whoever wins will have a tough job selling the plan to the public. It might involve creating lakes to supply water to the new, bigger locks, and flooding land and displacing some of the poorest people in Panama. Activists and churches are already rallying to their cause.

And the next government will have to champion the enlargement whilst staying strictly out of the canal's finances. Eyebrows were raised when Mrs Moscoso's government included the PCA's profits (about $90m) in its public-sector accounts, to get a growing deficit down to the 2% stipulated by Panamanian law. This breached an assumption that canal and government money would be kept separate. It also raised fears that, as the growing liabilities of the country's pension system pressurise the public finances, politicians will be tempted to raid the canal's coffers.

That would gravely undermine the integrity of the PCA, and jeopardise its ability to raise the money for the upgrade. To avoid temptation—and, potentially, catastrophe for the canal—the new government will have to cut the budget deficit, and address those pension liabilities. Are the next president and Panama itself—still a young democracy—up to the job?

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Colombia's president

Double or quits

Apr 29th 2004 | BOGOTÁ
From The Economist print edition

Will Álvaro Uribe get his second term?

Get article background

LAST week, President Álvaro Uribe made a surprise appearance on a Colombian radio show. A few days before, he had publicly endorsed a bill that would change his country's constitution and allow a president (ie, him) to serve a second term. If the bill passes—and if Mr Uribe won the election in 2006—he could stay in office until 2010. On the airwaves, he claimed that the opposition of Andrés Pastrana, a former president, to the idea sprang from "personal animosity". Let the people decide, he said.

Mr Uribe argues that Colombia needs another dose of his strong-arm "democratic security" policy, which has gone some way towards restoring order in a country torn by a 40-year, three-way battle between Marxist guerrillas, right-wing paramilitaries and the state (not to mention the drug-traffickers). "The country cannot vacillate in matters of public order," he said. "I ask God that Colombians don't make a mistake in 2006."

His kinder opponents worry that the president will now devote his time to electioneering, rather than running the government. Others point out that during the 2002 campaign, Mr Uribe said he was against re-election; changing the rules midway through his term seems unsporting. Then there are the unhappy precedents of other Latin American strongmen who have made similar changes to extend their rule.

Will Mr Uribe get his way? He is a skilful campaigner, and is already hugely popular. The constitutional amendment is supported by an overwhelming majority of Colombians—72%, according to one recent poll. All the same, the bill faces eight tortuous debates in the Colombian Congress. It is likely to survive the first this week, largely because Mr Pastrana's Conservative Party decided to lend its support, even after Mr Uribe's insult.

But the Conservatives came on board only after Mr Uribe acceded to their demands to increase social spending. More horse-trading—on policy, and on political appointments—will be needed if he is to succeed. Mr Uribe risks exchanging his reputation as an independent, corruption-busting warrior leader for that of just another callow politician.

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Mercosur and the EU

Still prickly

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The many meanings of a trans-Atlantic trade deal

IT RESEMBLED a courtship of porcupines. Mercosur, a four-nation trade block led by Brazil, is traditionally nervous about imports, but eager to sell agricultural products to the rest of the world. The European Union heavily subsidises its farmers, who are politically allergic to extra-European food. The two groupings have been talking about a free-trade deal for four years, but few observers thought they would consummate one soon. Now, suddenly, it looks as if a free-trade area embracing nearly 680m European and Latin American consumers, and $11.6 trillion of GDP, could be signed by October.

Yet the prickliness remains. As talks continued this week, each side was grumbling that the other had failed to present sufficiently alluring offers (indeed, there was some dispute about whether offers had been presented at all). The EU wants Mercosur to offer more liberalisation of trade in services and, more important, a chance to compete for government contracts on an equal footing with local companies. Mercosur wants lower barriers for such products as meat and sugar. They will try to sort out these differences in Brussels in early May. A senior Brazilian diplomat this week said that he is “not overly concerned at this stage”, though he sounded more hopeful a week before.

For both partners, political considerations are as important as strictly commercial ones, if not more so. Europe has long looked warily upon the United States' project of uniting the western hemisphere in a Free Trade Area of the Americas, which would be governed by rules on trade and investment written far from Brussels. With the American election stalling the FTAA, the EU can pull off a coup by striking a deal in the United States' backyard.

Are the Europeans also trying to bribe Brazil to betray fellow members of the G20, the group Brazil co-founded to defend developing-country interests in global trade negotiations? This has been alleged in press reports and hotly denied by diplomats on both sides. Brazil, flushed with a victory in a dispute over American cotton subsidies (see article), does not want to surrender its G20 leadership. Alfredo Valladão, who holds the “Mercosur chair” at l'Institut d'Etudes Politiques, a French university, thinks Brazil will continue to press for concessions by rich countries at global talks. That said, though, “in practical terms you cannot...start beating Europe every day” if you become its partner.

For Mercosur, one big political prize will be a stronger hand in negotiating the FTAA. The Americans have been pushing for more economic integration than Brazil wanted, without making clear how far they would reduce barriers to agricultural and other imports. The prospective EU deal “will prod America after the election to perhaps move a little faster to level the playing field with European competitors,” says Jeffrey Schott, of the Institute for International Economics in Washington, DC.

The result may be two deals that achieve less economic integration than the Americans want for the FTAA. But Mercosur, an aspiring customs union that has yet to free trade fully among its own members, may grow up in the process. Mr Valladão points out that the EU will press for its goods to circulate freely within the block. That could force Mercosur's four porcupine-like members to take seriously their own commitment to integration.

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Canada's provinces

Skint

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The federal government is in the black, but the provinces are feeling the pinch

IF CANADA'S prime minister calls a general election very soon, as well he might, Paul Martin and his fellow Liberals will doubtless spend much of the campaign crowing over their balancing of the federal government's books for seven years in a row. “Rock-solid fiscal discipline” is how Ralph Goodale, the finance minister, sums up the budget he presented in March. But his counterparts in Canada's ten provinces are less impressed. Most are struggling to make ends meet—and blame Ottawa for their predicament.

Provincial governments play a big part in Canadians' lives, with primary responsibility for health, education and welfare services. In nine provincial budgets also tabled in recent weeks, those services have been squeezed. Only Alberta—flush with oil and natural-gas royalties—is comfortable. Elsewhere, public-sector workers have been warned to expect meagre or no pay increases over the next few years.

The result has been labour unrest from coast to coast. Newfoundland and Labrador's finance minister announced plans to trim his province's civil service by 14%, or 4,000 jobs, helping to provoke a strike that crippled public services for almost a month. In British Columbia, 43,000 hospital workers walked out in protest at cost-saving plans to privatise some posts.

But the biggest trauma may be yet to come—in Ontario, the most populous province, which is due to table its budget on May 18th. With a deficit of close to C$8 billion ($5.9 billion) last year, Dalton McGuinty, the provincial premier since last October, has acknowledged that “we're in a pretty deep hole”. Mr. McGuinty has already taken some belt-tightening measures, such as revoking corporate tax-cuts and looking at ways to give private firms a bigger role in building and operating hospitals and other public services. Still, Mary Webb, of the Bank of Nova Scotia, thinks it will be three years before Ontario's books balance.

Who is really to blame for this malaise? To be sure, the provinces are paying heavily for the new responsibilities given to them by Ottawa. Social welfare—previously a shared programme—is now run entirely by the provinces, whose politicians thought that was an excellent idea in the booming 1990s. It seems less clever in today's economic doldrums. “All the bad effects of the down cycle were dumped on the provinces”, notes Mike McCracken, president of Informetrica, an Ottawa economic-research firm. Mr McCracken says that cutbacks in federal unemployment benefits have further strained provincial finances by pushing more jobless people onto the welfare rolls.

Yet the feds are not the only villains. As in other developed countries, administrations across Canada are struggling to rein in health-care spending—by far the biggest and fastest growing item in their budgets, accounting for a third of total revenues (and still climbing). Newfoundland's health-care budget, for example, has ballooned by 70% over the past decade. Mr Martin's government has earmarked C$2 billion of its 2003 surplus to help fund provincial health-care spending. But its generosity will depend on the provinces agreeing to reforms, such as the introduction of national caps on waiting times for operations. As Canada's provinces have discovered painfully, there is no such thing as a free federal hand-out.

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Mexico

Chilango heaven

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What explains the allure of Mexico's new boomtown?

WHERE is the best place to live and do business in Mexico? Consulta Mitofsky, a consultancy, thinks it knows, based on a range of supposedly measurable indicators such as economic and infrastructure development, and levels of crime and corruption. The winner is the eponymous capital of the state of Querétaro.

Querétawhere? The steamy, colourful port city of Veracruz; Guadalajara, home of tequila-drinking and *Mariachi* music; the manifold attractions of Mexico City, with its 10m population: all are better known to many Mexicans. Querétaro's main point of interest, according to the guidebooks, is its large bus station.

Yet people have been moving there in droves. The population has grown fourfold since the mid-1970s, to about 800,000; it grew faster than that of any other Mexican city during the 1990s. Querétaro's government reckons that 500-odd businesses have relocated there in the past seven years, many of them multinationals.

That includes Kellogg's, which has its regional headquarters in the city. All the big names in auto-parts manufacturing have presences in Querétaro. There are also 23 research-and-development centres in town, testifying to the skills of the local workforce and of the recent arrivals. Few of the new jobs are of the low-wage type associated with Mexican *maquiladora* manufacturing. Santander Serfin, a Spanish-owned banking group, is set to open a headquarters in town later this year, providing about another 2,500 salaries.

So why Querétaro? Businessmen such as Victor Amieba, who now owns a Querétaro printing works, point to its location. The main artery of Mexican-American trade (known as “the NAFTA highway”) runs through the city, which is also eight hours by truck to the border. The port of Veracruz is a six-hour hop away, and Mexico City much closer. No other base gives such access to both the central Mexican and the American markets.

But “quality of life” is probably the biggest draw: low crime, clean air and unclogged roads. This is particularly true for the refugees from Mexico City, known mysteriously as *chilangos*, who have been driven out by the constant threat of crime and traffic-jams in the capital.

Armando Rivera, Querétaro's mayor, says the low crime-rate is the result of policies that other cities could easily adopt as well. Take kidnapping, the scourge of middle-class *chilangos*. The state of Querétaro deters kidnappers with the threat of 50-year jail sentences, just about the toughest in the country. Many people in Querétaro actually walk around the city on foot, which is almost unthinkable amongst the bullet-proofed SUV classes of the capital. This is a big draw for nervous foreign middle-managers, who also maintain that there is very little official corruption.

And unlike other Mexican cities, Querétaro chose not to tear down its colonial centre (now a World Heritage Site), some of which is pedestrianised. It is kept impressively smart by an army of 650 cleaners. The test now will be for the city to remain beautiful as it gets ever bigger.

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The oil wars

In the pipeline

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Corbis

China and Japan are locked in a fierce diplomatic and economic struggle to win access to Russian oil

THE oil city of Daqing, in the bleak plains of north-eastern China, was once a proud symbol of the country's self-reliant spirit. The discovery of huge reserves there in 1959 allowed China to end its dependence on Soviet oil supplies, and fortified the country in its subsequent cold-war struggle with its fellow communist neighbour. Daqing's ubiquitous rigs still pump away, but output from the ageing field is dropping off. Meanwhile, China's economic boom has produced a growing hunger for energy that only foreign supplies can satisfy. Energy strategists in Beijing now see great promise in the former Soviet Union. Unfortunately, so too does China's old rival, Japan.

If China has its way, Daqing would be the terminus of a crude-oil pipeline beginning 2,300km (1,430 miles) away in Angarsk, at the southern end of Lake Baikal in eastern Siberia. And if Daqing has its way, it would become a refining centre for the Russian oil, which would help revive the fortunes of a city plagued a couple of years ago by large-scale protests involving laid-off oil workers. The pipeline could provide 20m-30m tonnes of crude a year, the equivalent of up to 30% of China's current imports. But Japan's rival idea is to pipe the oil instead to the port of Nakhodka, where it could be shipped to Japan and other markets (including China). A branch line could in theory be built to Daqing, but doubts abound on all sides as to whether there would be enough oil in Angarsk to fill it.

Promising though eastern Siberia's oil resources appear to be, they have yet to be tapped commercially. Even to be sure of filling the original proposed pipeline to Daqing, Russia would have to depend initially at least on supplies from the better developed fields of western Siberia. But this did not stop Japan wading in a year ago with its proposal for a route that would cost nearly twice as much (about $5 billion) and take far longer to build than the Daqing line—to the intense fury of the Chinese who thought they had a deal sewn up.

Many analysts believe that the Russians may now favour Japan over their “strategic partners” in China. The Japanese scheme would avoid dependency on a single market. It also includes provisions for billions of dollars of Japanese investment in oil exploration in eastern Siberia—much needed if Russia is to realise the full potential of the area (though possible Japanese investors, worried about the economic viability of the project, have been lukewarm to the idea). And the chief Russian backer of the Daqing proposal, the private oil company Yukos, suffered a severe blow to its political influence with arrest of its chairman, Mikhail Khodorkovsky, last year on charges of fraud and tax evasion.

Oksana Antonenko of the International Institute for Strategic Studies in London believes the Russians have already decided on the Nakhodka route. This, she says, would fit better with Mr Putin's plans to develop the Russian Far East, since the Nakhodka line would be better able to supply domestic markets as well as foreign buyers. The possibility of building a branch line to Daqing would theoretically be kept open, “but this diversion would simply not ever happen.”

Where would this leave China? Its biggest concern is protecting itself against the price volatility of international markets. At present, China imports about a third of its oil requirements. This could rise to some 60% by 2030. More than half of China's oil imports come from the Middle East. The oil is shipped through the Malacca Strait between Malaysia and Indonesia, an area notorious for well-organised piracy. China's navy is ill-equipped to carry out duties much beyond its shores. Instability in the Middle East, and its impact on prices, has focused the minds of policymakers across North-East Asia on the need to diversify their supplies.

Uncertainty over the Daqing scheme and worries about the Middle East have made China all the keener to explore other options. A long-standing proposal for an oil pipeline from Central Asia to China, which had made little headway because of cost concerns, is back on the table. President Nursultan Nazarbayev of Kazakhstan is due to visit Beijing in mid-May and is expected to sign an agreement on the construction of a 1,200km cross-border section of the pipeline from Atasu in Kazakhstan to Dushanzi in China's Xinjiang region. Work could begin this summer and be completed possibly within a couple of years.

The pipeline would link up with Kazakhstani pipelines connecting to the Caspian Sea region, far to the west. Even so, the oil would still have far to go before reaching the booming coastal areas of China where it is needed most. It is an extremely costly proposition (Chinese reports suggest around $3 billion just for the route from Kazakhstan to Xinjiang) for a projected supply of 20m tonnes a year. But Scott Roberts of Cambridge Energy Research Associates, a consultancy firm, says that while the costs are high “there is a strategic value at stake. China's oil security is increasingly important to its overall economic and political security and from that standpoint, yes, it makes great sense if you can ensure that the supply reaches your market reliably.”

China has offered a spectacular demonstration of its willingness to lavish money on strategically

important energy schemes, with its 4,000km (2,500 mile) natural-gas pipeline from Lunnan, in Xinjiang, to Shanghai. This $15 billion project, one of China's costliest-ever infrastructure developments, is due to become fully operational later this year, ahead of schedule. China sees the development of Xinjiang's backward economy as important to the country's stability. It is also eager to promote the use of gas, which is less polluting than China's main energy source, coal. By the time the Xinjiang gas reaches consumers in eastern China, its price will hardly be competitive with that of alternative fuels. But that is of little concern in Beijing.

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North Korea

Keep off

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The things North Korea attempts to hide

Get article background

FOR once, no cover-up. After the massive explosion on April 22nd that razed part of the town of Ryongchon, close to the border with China, North Korea made a rare appeal for international help for the survivors. A sign that the “hermit kingdom” is slowly inching out of self-imposed isolation? So its neighbours, frustrated in their efforts to coax North Korea out of its nuclear bunker, might wish. But it was quickly back to prickliness as usual.

AP

A tragedy hard to conceal

There was no disguising the blast, which brought destruction over a 4km (2.5-mile) radius. It was set off by sparks from a cable that ignited chemical fertiliser in wagons being shunted around a rail yard some nine hours after a special train had passed nearby, carrying North Korea's leader, Kim Jong Il, home from a “secret” visit to Beijing. More than 160 were killed (half of them schoolchildren), over 1,000 injured, and perhaps 10,000 left homeless.

Yet, not for the first time, the way the North Korean authorities handled the tragedy seemed to make matters worse. Visiting aid officials saw children in a nearby hospital writhing in pain, their facial wounds stitched with rudimentary twine. Yet Chinese hospitals just over the border, standing by to receive victims, were sent none. South Korean officials, offering to truck in urgently needed supplies, were told to send them (more slowly) by sea. Letting North Koreans see South Korean aid lorries was evidently more than the regime could tolerate.

The United States and Japan, as well as China, Russia and others, have also pledged assistance. The World Food Programme (WFP), still working to mitigate the effects of a famine in the mid-1990s, called for an extra 1,000 tonnes of food.

But North Korea is not easy to help. Mr Kim's infallibility complex—the official press offers only paeans of praise for his talents in everything from potato growing to golf—and an obsession with secrecy serve the country ill. In the several years before famine was acknowledged, perhaps 2m died from that and related causes. Several charities have pulled out, citing unacceptable restrictions on their work.

Behind the façade of a “workers' paradise”, North Korea has more than food shortages to hide. An Amnesty International report recently blamed the regime for exacerbating the food crisis and for related

human-rights abuses. There have been persistent reports among those who have fled the country in search of food, of forced abortions for pregnant women returned by China, and of infanticide.

Last year an American-based lobby group, using satellite photographs and testimony from former prisoners, documented what it called North Korea's “hidden *gulag*”, a sprawling network of labour camps where up to 200,000 prisoners, some incarcerated for nothing more than being the parents or offspring of supposed mischief-makers, work in harsh conditions. A BBC documentary earlier this year reported accusations that prisoners have been used for gruesome experiments with deadly chemicals.

North Korea denies all this, despite corroboration from some among the more than 3,300 refugees who in the past four years have found their way to South Korea. Last month, the UN's Commission on Human Rights called on North Korea to allow experts in to investigate these and other accusations. The answer, predictably enough, was no.

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Democracy in Hong Kong

On hold

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China has ruled out any further steps towards direct elections

Get article background

AP

Debating constitutional reform

“HONG KONG'S future development will be shaped by the people of Hong Kong,” said China's affable prime minister, Wen Jiabao, during a visit to the former British colony last summer. Now Mr Wen and his colleagues in Beijing have apparently changed their minds. This week they made it clear that, despite strong support in Hong Kong for full democracy, China is having none of it.

The decision to rule out any meaningful political change in Hong Kong, at least for another eight years, was announced by China's rubber-stamp parliament, the National People's Congress (NPC). It followed weeks of increasingly strong signals from Beijing that the central government wanted to put an end to lively debate in Hong Kong about the possibility of greater democracy in 2007, when a new chief executive is due to be chosen, and in the following year, when a new legislature will be formed.

The NPC's Standing Committee ruled, after a typically closed-door two-day session, that the chief executive would not be elected by universal suffrage in 2007. And no more than half the seats in the legislative council, or Legco, would be filled through open election. The other half would continue to be filled by representatives of business sectors and various professions, chosen by colleagues in the same line of work. Hong Kong's business community tends to support China's policies in the territory and to oppose the introduction of universal suffrage.

China's official justification for putting its foot down is that rapid moves towards full democracy could destabilise the territory. In fact it is probably more worried about losing its control over the choice of Hong Kong's leaders, which in turn could lead to growing confrontation between Hong Kong and a central leadership resolutely opposed to anything much resembling western-style democracy. Hong Kong's current leader, Tung Chee-hwa, was chosen by an 800-member election committee packed with supporters of the Chinese Communist Party's line.

Many in Hong Kong had high hopes for Mr Wen and his boss, President Hu Jintao, when they took up their posts early last year. They were often portrayed in the local media as being somewhat more in tune with public concerns than their predecessors. During his trip to Hong Kong, Mr Wen upstaged the standoffish Mr Tung by visiting the widower of a SARS victim, kissing his daughter and holding his baby.

But the day of Mr Wen's departure coincided with the biggest anti-government demonstration in the territory since Britain handed over control in 1997, involving half a million people. In November last year, pro-China politicians suffered humiliating setbacks in Hong Kong's district elections. In March, Taiwan's pro-independence president, Chen Shui-bian, won a second term of office with a greatly increased share of the vote (though only a tiny lead over his opponent). These developments have prompted China to rethink its strategy.

To soften the blow, China has tried in recent days to reach out to Hong Kong's pro-democracy camp by holding its first official meetings with some of its leaders since the crushing of the Tiananmen Square protests in 1989. But the NPC's blunt declaration this week will only heighten antagonism. Pro-democracy activists are planning large-scale rallies, and China's political plans for Hong Kong will clearly now

become a central issue in Legco elections in September. China's latest ruling could well backfire.

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India

Master of Business Astrology

Apr 29th 2004 | DELHI
From The Economist print edition

The politics of business schools

INDIA'S six Institutes of Management have built international reputations in the past few years. Multinational as well as Indian companies regularly go to them for recruits, with banks like Morgan Stanley offering salaries of $100,000 or more to the best graduates from the best school, in Ahmedabad.

That would seem to be a good example of “India Shining”—the slogan used by the government in the lengthy general election that is now taking place. Unfortunately, Murli Manohar Joshi, the human resources development minister responsible for education, does not like such elitism—nor is he very keen on foreign companies. He wants to bring the colleges down a peg or two and has been trying to force them to reduce their fees from 100,000-150,000 rupees ($2,300-$3,400) a year to 30,000 rupees, arguing that they are beyond the reach of the poor. This would make them more dependent on government funding, and thus more susceptible to its control, and has led to a public row.

Mr Joshi, aged 70, is no stranger to controversy. He was one of the three leaders of the Bharatiya Janata Party (BJP) in the early 1990s, ranking alongside Atal Behari Vajpayee, now prime minister of the BJP-led coalition government, and L. K. Advani, the deputy prime minister. Now rather eclipsed, he has continued to push the BJP's Hindu-nationalist line. He has had school textbooks re-written by relatively unknown historians sympathetic to his views and has encouraged the introduction of university courses in Vedic astrology.

Mr Vajpayee let him pursue his targets, presumably because it placated the far-right of the Sangh Parivar, the Hindu “family of organisations” to which the BJP belongs, at a time when the government was going slow on more controversial issues. But the management institutes are headed by influential top industrialists including Narayana Murthy, founder of Infosys, one of India's biggest IT companies. Mr Murthy is chairman of the Ahmedabad institute, and has led a public attack on Mr Joshi's proposals. The row even went to the Supreme Court after Mr Joshi's ministry refused to pledge that it would not interfere with the colleges' autonomy.

This became too controversial for the government during a general election and Mr Joshi has been gently side-lined by his colleagues—even though three or four of the financially weaker and more easily pressured colleges have more-or-less fallen into line. A clause was specially drafted in the BJP's manifesto pledging autonomy to “centres of excellence”. Mr Joshi has got the message and is lying low. A settlement now looks likely after the election, with the institutes offering more scholarships and cheap loans for poorer students—and charging higher fees for their recruits.

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Thailand

Southern discomfort

Apr 29th 2004
From The Economist print edition

A day of mayhem may herald trouble for a once-impregnable prime minister

Get article background

TO SOLDIERS in southern Thailand, a spell with the Thai contingent in Iraq must seem like a plum assignment at the moment. In the provinces of Songkhla, Pattani, Yala and Narathiwat, mysterious militants have been attacking security posts, burning schools, bombing government offices and sabotaging train tracks. Since the beginning of the year, they have assassinated some 100 soldiers, policemen, informants, and officials. On April 28th, the violence reached new heights, when the security services fended off a co-ordinated series of around ten attacks, killing 107 of their assailants in the process and losing five of their own men.

Thailand's Malay Muslim minority has long complained of neglect at the hands of the Buddhist majority. Over the years, various groups have taken up arms against the government, often in the name of unity with their brethren across the border in Malaysia. By 2002, however, the insurgency seemed to have petered out—so much so, in fact, that Thaksin Shinawatra, the prime minister, ordered the closure of the special joint command of local police and army units designed to tackle it. Since then, the fighting has gathered pace again.

Last year, hit-and-run attacks claimed the lives of one or two policemen a month. Now, there are daily assaults on a much wider variety of targets. The militants have bombed a bar patronised by Malaysian tourists and even hacked several Buddhist monks to death with machetes. The government has tried various tactics to rein in the violence, with no success. At first, Mr Thaksin declared martial law and sent in the security services to track down the perpetrators. But locals complained of harassment and abductions at the hands of the authorities. Mr Thaksin then replaced his defence and interior ministers, as well as the local army commander, and ordered a milder approach.

The authorities still do not seem to have any clear idea whom they are fighting or why the violence has escalated so quickly. The rapid turnover of officers, along with the dissolution of the joint command, has left the security services with little local intelligence. At various times, different officials have described the attackers as Muslim separatists, mafiosi, and arms smugglers. Many consider them terrorists, and have hinted at connections with outfits like al-Qaeda or Jemaah Islamiah.

Mr Thaksin, however, insists that the problem is purely domestic. He blamed the latest wave of violence on bandits backed by local politicians. But Mr Thaksin has provided so many pat explanations of the conflict that his assurance is beginning to look like bluster. He may also be vulnerable to the charge of disproportion: 30 of those killed on April 28th were said to be sheltering in a mosque, and most were armed only with machetes.

The situation in the south is more a source of bewilderment than alarm to most Thais, but it has dented the prime minister's aura of invincibility. What with a mishandled outbreak of bird flu earlier in the year, and an ongoing battle with the unions over privatisation, Mr Thaksin has found himself uncharacteristically on the defensive. An election is due by next January—and Thailand's once-despairing opposition are looking energised.

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Laos

Unintended consequences

Apr 29th 2004 | VIENTIANE
From The Economist print edition

Calls to re-legalise opium

Get article background

THE Laotian government's pledge last year to end the cultivation of opium poppies by 2005 was music to the ears of international narcotics-control agencies and donor governments alike. But in a country where over 40% of the population are hill-tribesmen, many of them dependent on opium as a cash-crop and for medicine, it is proving tricky.

International NGOs are worried about the humanitarian cost of the war on drugs, which has already caused the displacement of some 25,000 Hmong, Akha, and other tribes from their traditional homes in the mountains to the valleys. The UN's drug-control agency admits that crop-substitution projects cover only a few areas. But an international survey has shown that in areas where no alternative crops were in place, malaria and dysentery have ravaged the resettled villages and annual mortality rates have risen to 4% on average—and up to 20% in one village. The national rate is 1.2%. A Vientiane-based ambassador concludes that if the government insists on total opium elimination by 2005, a disaster could result.

Laos, one of the poorest countries in Asia, has long been pressed by donors to get tough on narcotics. Until a few years ago, opium cultivation and consumption by the mountain peoples was still legal: only trafficking was prohibited. But all that changed after the UN persuaded its member states to adopt a total eradication policy by 2008.

Aid-dependent Laos was pressured by donors to abandon its previous tolerance towards the opium economy of the Hmong and other groups. But now some western embassies are having second thoughts, quietly advising the communist government to slow down until basic services are in place. There is also a growing recognition that the alien influx of *yaa baa* (amphetamines) from neighbouring countries poses a far greater threat to society than the long-established custom of smoking opium.

Besides, one Laotian development specialist argues that international drug policies are unfair to his people, citing the examples of other countries, including India and Turkey, where farmers benefit from legal opium cultivation for the production of pain-killers.

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Iraq

Still a cauldron, not a quagmire

Apr 29th 2004 | BAGHDAD AND NAJAF
From The Economist print edition

AFP

As the countdown to a handover to Iraqis begins, the Americans are still desperately trying to restore a modicum of security

Get article background

SADDAM HUSSEIN'S birthday, April 28th, is engraved in Fallujah's heart. Two years ago this Sunni Muslim stronghold held a grand party for its president. Last year, after his fall, a small demonstration in protest was dispersed by American gunfire, leaving 18 people dead and prompting the first post-war call to revolt. This year, to celebrate his 67th birthday, Fallujah was facing bombardments from tanks and aircraft. A minaret used by snipers was toppled. Dozens of houses were destroyed.

Spokesmen for the American-led coalition belittle their opponents, in Fallujah and elsewhere. They are drawn, say the Americans, from the ranks of drug-dealers and foreign terrorists. Be that as it may, they have killed more American troops (so far, at least 124) in April's battle for two small towns as died in the rapid conquest, a year ago, of all of Iraq. Fallujah and the southern Shia city of Najaf, have been under an American siege for almost a month, although on April 29th, it looked as if the Americans were starting to withdraw from parts of Fallujah.

As Iraqi civilian casualties have risen, trust in the Americans has slumped. Toppling minarets, however militarily justified, does not enthuse ordinary television-watching Iraqis. Frustrated and cash-strapped after 12 months at home, many of the men who had served in Mr Hussein's army, which melted away a year ago and was then formally disbanded by Paul Bremer, the American proconsul, have taken up arms again—as guerrillas. Former generals say they earn their keep training recruits to make and deploy explosives. Sunni ex-officers have slipped into Fallujah. Shia ones fill the ranks of the Mahdi army that gathers round Muqtada al-Sadr in his Najaf redoubt. Doctors from the former army tend the wounded. Few are full-time insurgents; sometimes they are forced to join the fray. But even American soldiers privately admit that they are operating as well-trained units.

The insurgents' attacks have escalated from roadside bombs to co-ordinated assaults on American forward positions. The fighters have used stocks of arms stashed in cemeteries. They say that Soviet-made infra-red detectors, smuggled in through Syria, have helped them shoot down helicopters, forcing the Americans to resort to high-flying aircraft. This week the Americans apparently killed 64 Iraqi militiamen in a bombardment to knock out an anti-aircraft gun near Najaf.

Flush with ransom money for foreign hostages, the rebels can and do pay high prices for weapons and ammunition. The rebels' favourite television channel, al-Jazeera, broadcast a statement from one group offering a bounty of $15m for anyone who kills a top American commander.

The guerrillas are hailing this week's departure of the last of Spain's 1,300 troops, with two small Latin American contingents set to follow, as a victory. Reconstruction is faltering. Supply lines have been interrupted, foreigners kidnapped and hundreds of Iraqis killed as collaborators. Sometimes barely half the Iraqi staff at al-Iraqiya, the American-funded national broadcaster, turns up for work. Hundreds of foreigners working for the US Agency for International Development, for the construction firm Bechtel, and for ABT Associates, which has a contract worth $40m to revamp the health ministry, have been withdrawn to Amman, the capital of neighbouring Jordan. Several firms have moved their staff to the safer Kurdish part of Iraq. The postponed Baghdad Trade Fair is being relocated to Turkey.

A knock-on effect of this foreign exodus is that hotels have laid off workers and in some cases have closed their doors. Projects have been postponed. More factories have suspended work. Unemployment is up again. Above all, Iraqis are warier of co-operating with the coalition for fear of being on the losing side.

Sunni religious leaders have stepped up their anti-American rhetoric, from the pulpit and via CDs. So have Arab satellite television channels. Many Sunni preachers have ties with the most influential of Mr Hussein's comrades still at large, Izzat al-Douri, who patronised some of their cults. The Muslim Scholars' Council, a branch of the Muslim Brotherhood, is ensconced in Baghdad's vast Mother-of-All-Battles mosque, whose huge marble map still shows Kuwait as part of Iraq. The Salafi movement, which helped spawn Osama bin Laden, controls the towering mosque of Ibn Toubal. And a Sufi mystic from Fallujah, Mahmoud Eissawi, presides over the elephantine Gailani mosque in Baghdad, urging the country's myriad Sufi lodges to stop meditating and to fight.

Many Sunni mullahs and former army officers still say, however, that they would co-operate with the Americans if they were included in the new order and were offered a slice of new business. “We know you are a kingdom of freedom and human rights and even the Baathists wanted regime change,” says Fakhri al-Qaissi, a leading Salafist. “But instead we got liars and fools. This isn't liberation.”

The Sunnis' top ten

Name	Post	Party	Qualifications
Adnan Pachachi	Possible president or prime minister*	Iraqi Independent Democrats	Patrician last active in Iraq in the 1960s as foreign minister before departing to the Unit where he advised Sheikh Zayed of Abu Dhabi. His extensive knowledge of the UN makes confidant in Iraq of the UN's envoy, Lakhdar Brahimi, who might give him a big job in a government. At 80, he is tired.
Sherif Ali bin Hussein	Possible speaker of national council†	Constitutional Monarchy Movement	Scion of Iraq's old Hashemite royal family, he seeks to revive a pro-British monarchy. Ex American-appointed Governing Council (GC), he plays on his descent from the Prophet M could emerge as the unifying figure Iraq craves.
Muhammad Obeid al-Kubaysi	Probable national council member	Muslim Scholars' Council	A Fallujah preacher from a Sunni clerical family who, like the Shia cleric, Muqtada al-Sa more radical after the Americans sidelined him. His Muslim Scholars' Council, in essence anti-American Iraqi wing of the Muslim Brotherhood, stands for angry Sunnis and Baath
Samir Sumaidy	Interior minister	Iraqi Democratic Alliance	Best-dressed GC member, appointed interior minister in April. Originally from Fallujah b much of his life in London and Beijing is unrecognisable to most of the troubled town's
Mohsen Abdel Hamid	Probable national council member	Iraqi Islamic Party	A GC figure who heads Iraq's offshoot of the Muslim Brotherhood. Once a professor of A in Baghdad, he has been unabashed at the prospect of working with Baathists and Amer
Ibrahim Izzat al-Douri	Insurgent mastermind	Baath	The most senior Baathist still at large, with a bounty of $10m on his head. As Mr Hussei had responsibility for Iraq's religious affairs, so made alliances with many Sunni religio and has a reputation as a Sufi mystic.
Ghazi al-Yawer	Probable national council member; current GC member	Tribal leader	Born in Mosul, son of leader of Shammar tribe, one of Iraq's largest. Civil engineer said nationality. Appointed to the Governing Council.
Fakhri al-Qaissi	Probable national council member	Supreme Council for Guidance and Call	Dentistry professor at Baghdad University who says Mr Hussein imprisoned him 30 time Salafism, Islam's puritanical fundamentalist creed. He says he is non-violent but Americ they uncovered an arsenal in his Baghdad mosque.
Najib al-Salihi	Probable national council member	Free Officers' Movement	Commanded a tank battalion in Iraq-Iran war, before fleeing to US in 1995. Angry at ex GC, but now canvassing for January's elections.
Mezhar al-Dulaimi	Car-dealing franchise	League for Defence of Iraqi People's Rights	Former Iraqi attaché in Paris favoured by French and Egyptian governments. Perceived a hostage-takers after appearing on television to say that the abductors of three Japanes money. Flies plastic Renault flags in his garden.

Source: *The Economist* *In interim government due to take office on June 30th †Consultative body to be chosen by 1,000 or so members of a "big tent" selected by UN env

Taking the hint, Mr Bremer has gone on television to announce a rethink of his old deBaathification plan. He may now hire some senior Baathists, including a brother-in-law of Mr Hussein. A revamped defence

ministry, under an Iraqi general, is proposing to double the number of recruits to 80,000. Former generals and officers may now apply, so long as they have no blood on their hands. Some 11,000 teachers, previously sacked for being Baathists, are expected to get their jobs back. The search for influential Sunnis to bolster the regime (see table) is intensifying.

Ahmed Chalabi, the Pentagon's favourite on the Governing Council who chairs its committee for purging Baathists, is furious. It's like bringing back Nazis to run post-war Germany, he says. “DeBaathification is on and off,” mused Iyad Alawi, an ex-Baathist appointed to the GC last year. Several former army officers and Baathists have already started to canvass for the general elections due in January.

America still has to find a caretaker government to take office by June 30th, when the Iraqis are supposed to take over and run the show (with Americans pulling many of the strings) until January. The UN's envoy, Lakhdar Brahimi, has been asked by President George Bush to choose a government, but is facing objections from the GC, largely because it will lose power, and also from Iraqis in general, who are loth to see a foreigner, albeit an Arab (from Algeria), select their new rulers. This week, however, Mr Brahimi said he still hoped to present an acceptable government (Sunnis included) for the interim, by the end of May, while noting that Iraq's insecurity was “extremely worrying”.

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The UN's oil-for-food row

The biggest scandal ever?

Apr 29th 2004
From The Economist print edition

There are now seven inquiries into an alleged UN oil-for-food scam. Why?

Get article background

“IF THERE is truth to the allegations that the Iraqi regime, with assistance from UN officials in some cases, wrongfully acquired $10.1 billion through smuggling oil, oil-sale surcharges, and illegal commissions on oil-for-food contracts, this represents a scandal without precedent in UN history,” says Henry Hyde, chairman of America's congressional committee on international relations.

A fellow Republican congressman, Christopher Shays, who chairs the government-reform sub-committee, goes further. The alleged bribes, surcharges and other improprieties surrounding the UN's oil-for-food programme that was worth a total of $67 billion could, he says, turn into “the biggest scandal ever”. Ahmed Chalabi, a member of Iraq's American-appointed Governing Council (GC) calls it “the biggest political bribery scandal in history.”

And so it goes on. But so far little hard evidence has come to light beyond a list of 265 supposed beneficiaries of the former Iraqi dictator's illicit largesse in 52 countries, including all five permanent members of the UN's Security Council. Among those named are Indonesia's President Megawati Sukarnoputri; Charles Pasqua, a former French interior minister; and Benon Sevan, who ran the UN's oil-for-food programme. All deny any wrongdoing.

There are dark hints that Kofi Annan, the world organisation's secretary-general, could find himself compromised. Much has been made of the fact that his son, Kojo, worked for a company that won a juicy contract under the oil-for-food programme. (He did, but left before the contract was awarded.) France and Russia have been accused of opposing the war in Iraq because influential individuals in those countries did not want to lose their bribes. Some even suggested that the UN itself, which received more than $1 billion for administering the six-year programme, may have been loth to see the end of such a lucrative source of income.

Under the programme, set up in 1995 to alleviate the hardship caused by the UN's economic sanctions against Iraq, Mr Hussein was allowed to sell limited amounts of crude oil (the ceiling was removed in 1999) in order to pay for food, medicine and other essentials. Still a sovereign country, Iraq was permitted to choose to whom it sold its oil and from whom to buy goods. But the oil buyer had to pay the price, approved by the UN sanctions committee, into a UN escrow account. Part of that cash was then used to pay for food and drugs, again supervised by the UN sanctions committee, which included representatives of all 15 Security Council members.

But from the outset Mr Hussein managed to skim off nearly $2 billion a year into his own pockets, both by running extensive smuggling operations outside the oil-for-food programme and by demanding kickbacks from purchasers and suppliers within the scheme. He also allegedly gave allocations of oil at discounted rates in the form of vouchers, which could be resold at a handsome profit in return for favours: goods not permitted under the oil-for-food programme, political support on the world stage, and so on.

Why blame us?

Much of this has been known for at least three years. What is new is the magnitude of the scam and the naming of people and organisations allegedly involved in the voucher scheme. A senior UN official acknowledges that it was “entirely possible, indeed probable” that the former Iraqi dictator used

loopholes in the programme to extract kickbacks. But because of the scheme's complexity, he says there was no way of knowing anything about this. Member states, not the UN, were supposed to police smuggling. Many UN officials suspect that today's campaign is intended to discredit the UN so as to make a future role for it in Iraq impossible.

Foremost among the UN's accusers is Claude Hankes-Drielsma, a British financial adviser who was appointed by his old friend, Mr Chalabi, who chairs the finance committee of the GC in Iraq, to advise it on its investigations into the affair. Mr Hankes-Drielsma's allegations have been seized on eagerly by American neo-conservatives who have long regarded the UN as little more than a costly and corrupt talking-shop. Mr Chalabi has long been their candidate to rule the new Iraq.

In evidence to the Shays committee, Mr Hankes-Drielsma said that the UN oil-for-food programme had provided Mr Hussein “with a convenient vehicle through which he bought support internationally by bribing political parties, companies, journalists and other individuals of influence”. This, he said, had secured the support of dozens of countries, including key Security Council members.

“The very fact that Saddam Hussein, the UN and certain members of the Security Council could conceal such a scam from the world should send shivers down every spine in this room,” he said. He asked the United States and Britain to set up a “complete review of the UN, its function, and how it might operate effectively and with integrity”.

Mr Hankes-Drielsma may have jumped the gun. Nothing, so far, has been proved, certainly not as far as the UN is concerned. His evidence and nearly all the other allegations against the UN have so far been based on documents found in Iraqi government archives. But no one, other than he and the GC's 25 members, has seen or authenticated the documents.

No fewer than seven inquiries have been set up in an attempt to get to the bottom of this murky affair: three by American congressional committees; one by America's General Accounting Office, Congress's investigative arm; one by the Iraqi GC; another by Iraq's American-led Coalition Provisional Authority, itself due to be dissolved by June 30th, when the Americans are supposed to hand over government to Iraqis; and yet another, announced last week, by the UN itself, to be chaired by Paul Volcker, a former head of America's Federal Reserve.

“You can't sit on this and let it fester,” Mr Volcker said. “You have to get it investigated, whatever it shows. What is important is finding out whether there's any substance [to the allegations]. If there's not, and we've done as good an investigation as we can, that helps repair the damage. If there is, get it out there, get it out in a hurry, and cauterise the wound!” Mr Annan has told all his staff to co-operate fully with the inquiry. Anyone found guilty, he says, will be dealt with “very severely”.

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Syria, Jordan and Saudi Arabia

Plots and bombs

Apr 29th 2004
From The Economist print edition

Middle East violence touches the region's more stable places

TERROR attacks seem sadly commonplace the world over, yet they have been oddly rare in some of the big cities of the Middle East, a region many see as the eye of the storm. But in the past few weeks, bombs and gunfire have rattled sleepy Riyadh, the Saudi capital, and shaken the tomb-like calm of Syria's Damascus, while police in affable Jordan claim to have foiled an attack in which chemical weapons, they say, could have killed tens of thousands of people.

In both Jordan and Saudi Arabia the culprits appear to have been the usual suspects: cells of *jihadis* associated with al-Qaeda. For the past year, the Saudi authorities have been engaged in tit-for-tat exchanges with well-armed groups of militants. The latest bombing in Riyadh last week was unusual only in that it targeted the police directly, rather than the “infidels” that the insurgents say should be chased from Muslim shores.

Similarly, the Jordanian group's intended targets included the country's secret-police headquarters and the prime minister's office in Amman, the capital, as well as the fortress-like American embassy. Squeezed as Jordan is between the fires of the Palestinian *intifada* (uprising) and unrest in Iraq (where al-Qaeda's leader is said to be a Jordanian, Abu Musab al-Zarqawi), popular fury over the Jordanian government's close ties to America is unsurprising. What did surprise observers was not that a local al-Qaeda cell should be uncovered but rather the scale of its ambitions.

According to police reports and the televised confessions of four suspects, the ten-man cell had purchased some 20 tonnes of explosive material, a huge cocktail of other chemicals, and half a dozen vehicles, including heavy trucks fitted with battering rams. Although some Jordanians whisper that the authorities may have fabricated the plot, the tradecraft of the alleged terrorists looks very much like al-Qaeda's: huge, multiple bombings of symbolic targets.

This week's alleged terror attack in Damascus was more puzzling. Syria's secular-minded government may be hostile to Islamist radicalism but is also fiercely at odds with al-Qaeda's prime enemy, the United States. The few details of the attack revealed by police suggest different goals and methods from al-Qaeda's. Four alleged assailants are said first to have set off a weak car bomb outside an unused building in a smart suburb of Damascus, then tried to flee by tossing hand-grenades and firing wildly. Police say they killed two of them in the subsequent chase and nabbed the others. A female bystander and one policeman were also killed.

The repressiveness of Syria's regime—underlined by this week's trial of the country's leading human-rights activist, Aktham Naisse—tends to incubate conspiracy theories. Several are now circulating in Damascus. According to one, the foiled attack was not a terrorist bombing but a planned assassination of a senior Syrian official. Some, however, say the whole incident was staged by the authorities, both to divert attention from the trial of Mr Naisse and to allow Syria, a country that America accuses of sponsoring terrorism, to pose as an equal victim of the plague.

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Congo and Rwanda

Killers next door

Apr 29th 2004 | NINDJA, SOUTH KIVU
From The Economist print edition

Taxed by many, protected by none, the people of eastern Congo are angry

Get article background

THEY are the neighbours from hell. A band of Rwandan Hutu guerrillas—remnants of the militia that perpetrated the genocide of 1994—live in thatched huts at the base of a hill in Nindja, an area in eastern Congo's South Kivu province. At night, they venture out with their battered but still effective Kalashnikovs and demand tribute from the local population. In better days, they extracted a predictable 50 grams of manioc and 20 Congolese francs (5 cents) per person. These days, they pillage violently and indiscriminately. As well as robbing, they often rape.

“We get along fine with the Congolese,” said one, while pestering your correspondent for a cigarette. The locals beg to differ. Cows and goats no longer graze Nindja's bright green fields, having long since been stolen. Malnutrition curses more than half Nindja's people, though a local nurse remarks that she has never seen a malnourished Rwandan. The unwelcome guests show no sign of leaving.

Congo is supposed to be at peace. In the last two years, all foreign armies have withdrawn, and the main home-grown rebel groups have joined a power-sharing transitional government. But the new government in Kinshasa, Congo's capital, 865 miles (1,390 km) to the west, has made little effort to restore security in the country's turbulent east.

The worst problem is the presence of those Hutu rebels—perhaps 8,000 of them—in eastern Congo. Earlier this month, groups of them mounted raids into Rwanda. Last week the Rwandan army pursued them back into Congo, in violation of its own promises, according to the UN. Rwanda denies it, but the UN complained that a Rwandan officer had even threatened UN peacekeepers in Congo.

Rwanda's government is furious that neither the Congolese government nor the UN has dealt with the Hutu rebels, who it says still have genocidal plans. Probably most are too young to have taken part in the genocide, but many of their officers helped direct it. And they are tough. Commandant Serge, the leader of the pack in Nindja, sports a jagged scar on his jaw, and says he's “not tired of the bush”.

Almost everyone agrees that the Hutu rebels should be either crushed, or disarmed and sent home. But the Congolese army is too busy fighting with itself to help much. In February, in the eastern town of Bukavu, when a new commander from Kinshasa tried to assert his authority, his deputy, a veteran rebel, tried to kill him in the street. Now, rival battalions of the supposedly unified army glower at each other from opposite ends of town. Bukavu is more tense than it has been since the supposed end of Congo's complex war.

Easterners complain that the central government has been quick to levy taxes, but ignores their demands for security and passable roads. A planned tariff hike is about to make rice and medicine more expensive, particularly in the east. And inter-ethnic relations are turning touchy, especially in South Kivu. The Banyamulenge, a cattle-raising tribe related to Rwanda's Tutsis, proclaim loudly to anyone who will listen that certain Congolese are planning another genocide. Meanwhile, a new radio station, Radio Patriot, accuses the Banyamulenge of preparing another war.

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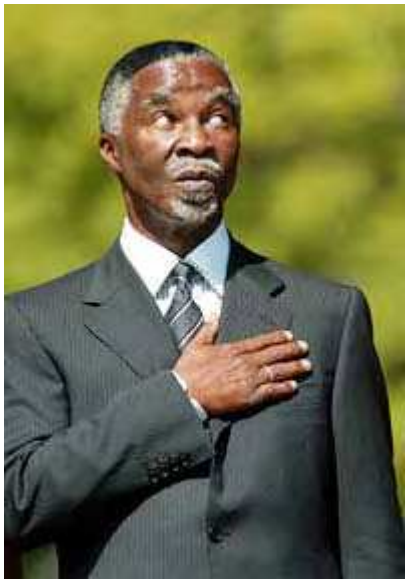
South Africa

In charge at home, hopeful abroad

Apr 29th 2004 | PRETORIA
From The Economist print edition

A president without rivals

Reuters



Mbeki's heartfelt ambitions

“A SMALL man with a big brain,” was how his traditional praise-singer reportedly described South Africa's president, Thabo Mbeki, at his inauguration. He has a big majority too: his party, the African National Congress (ANC), won nearly 70% of the vote and control of all nine of the country's provinces in an election two weeks ago. This week, as he began his second term to the sound of field guns, jets and pop stars, he looked unassailable.

Mr Mbeki's rivals are enfeebled. When votes were finally totted up, the largest opposition party, the liberal Democratic Alliance, had won barely 12%. Other parties fared even worse. The once-dominant New National Party now merely props up ANC rule in the Western Cape province; its leader was made minister of tourism in Mr Mbeki's new cabinet.

The Zulu nationalist Inkatha Freedom Party failed to win its home province of KwaZulu-Natal. It issued a clumsy legal challenge to the result, then withdrew it. It has been granted a sprinkling of posts in the KwaZulu-Natal provincial cabinet. But its leader, Mangosuthu Buthelezi, lost his job as home-affairs minister, and his party spurned two seats in the national cabinet. “I am out of it. But I still lead the second largest predominantly black party in parliament,” he said forlornly.

The ANC now enjoys unchallenged control of South Africa, and Mr Mbeki enjoys unchallenged control of the ANC. In most provinces, he did not bother to reveal the party's candidates for provincial premiers (in effect, governors) until after the election. Last week, he named them. Eight out of nine are new; some are practically unknown. All will owe a debt of loyalty to their benefactor.

In his national cabinet, Mr Mbeki kept most key ministers in their old jobs, including his deputy, Jacob Zuma, despite allegations of corruption. Alec Erwin, the widely-respected trade and industry minister, was moved sideways to run the ministry in charge of state-owned firms, which need to be sold off much faster.

What will Mr Mbeki do next? At home, he promised to fight poverty and entrench democracy. Abroad, he predicted that Africa would “emerge as a place of human hope”. Bold words, but ten months ago he predicted that Zimbabwe's problems would be resolved by mid-2004. That seems unlikely. And the standing ovation that President Robert Mugabe received at Mr Mbeki's inauguration suggests that many South Africans have misdiagnosed the cause of their neighbour's ills.

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Cyprus

An ominous European debut

Apr 29th 2004 | ATHENS, BRUSSELS AND NICOSIA
From The Economist print edition

EPA

The massive Greek-Cypriot "no" to a UN plan leaves confusion on the island and headaches for Europe

Get article background

THERE is a strange mood on Cyprus, considering that the country—or in practice, two-thirds of it—is in the process of realising a long-cherished goal, membership of the European Union. On an island where the usual atmosphere is one of absorption in private affairs, people listen attentively as public figures—Greek, Turkish and international—make wildly conflicting statements about the future.

Tassos Papadopoulos, the Greek-Cypriot president, blithely insisted on April 28th that UN efforts to reunite the island would continue—despite his own spectacularly successful effort to kill a UN blueprint to create a new, federal state: a proprosal presented by its main author, the UN secretary-general Kofi Annan, as a last chance (at least for a very long time) for a negotiated end to the island's division.

"I have repeatedly said that the Annan plan and all similar plans are always going to be on the table. They do not die, they do not disappear," declared the new standard-bearer of Hellenic defiance, who has struck a chord among nationalists in Greece as well as Greek Cyprus.

Is he right? Virtually nobody outside Cyprus would endorse the president's view that everything—or indeed anything much, in the realm of diplomacy—can go on as before, after the dramatic results of the vote among both Cypriot communities on April 24th. Egged on by Mr Papadopoulos, some 76% of the island's Greek majority delivered a resounding "no" to the settlement plan drafted by the UN secretary-general. As a result, the Greek-Cypriot administration exercised its right to join the Union alone on May 1st (along with nine other states) albeit under a cloud of resentment for turning down a deal which many outsiders, for better or worse, deemed a fair compromise.

The plan did involve risks, and concessions of long-held principle for the Greek side; but among the international bureaucrats (from the UN and EU) who had spent many months fine-tuning the draft, there was fury with Mr Papadopoulos for playing the rejection card so late in the day. "I would have to bite my tongue," said Alvaro de Soto, the UN envoy to Cyprus, when asked how he felt.

Among the Turkish-Cypriots, who would have joined the Union as a part of a loose federation if the plan had won general approval, there was a 65% vote for the UN proposal. On the northern side of Nicosia, the island's divided capital, a sense of historic change was in the air on the night of the poll as people demonstrated outside the home of Rauf Denktash, the hardline president of the unrecognised Turkish-Cypriot state, urging him to resign.

Mr Denktash—who remained a rejectionist to the last—retorted that he would have stepped down if the blueprint had been accepted: he “thanked God” for the Greek “no”, which relieves the Turks of any immediate pressure to make land concessions or bring troops home. Sceptical Turkish-Cypriots had started quipping that Mr Denktash's last remaining friend was Boncuk, his pet terrier; but objectively, he has found a new one—Mr Papadopoulos, the new father of rejectionism.

Very logically from his point of view, the Turkish-Cypriot leader described the Greek thumbs-down as a vindication of his own scepticism about the viability of the Annan plan. “Now it is completely dead, I shan't even keep a copy, and I have ordered all files on the plan to be thrown into the cellars,” Mr Denktash said of the UN document. In practice, though, the old thunderer has lost power—to moderates who are keen to co-exist with like-minded Greeks, assuming they can find some.

But will they find any? It is a depressing sign of how far apart the island's two communities now seem that each held celebrations on referendum night—for opposing reasons. There was a mood of irrational euphoria among the “victors” on both sides. The Greek-Cypriots have avoided the risks involved in any plan that requires them to dissolve the internationally recognised (but in practice, Greek-only) Republic of Cyprus; and to share money and political power with their Turkish neighbours.

AP

Tassos Papadopoulos: a new Mr No

The Turkish-Cypriots, for their part, have won a moral victory by sloughing off their image as the main obstacle to the federal, demilitarised republic which both sides claim to accept in principle.

What will be the net result? Senior figures in the EU are disgruntled at having to reward the Greek-Cypriot nay-sayers with the benefits of membership while keeping the more co-operative Turkish-Cypriots at bay. Everybody—even including the Greeks and Greek-Cypriots, in theory—now accepts the need to share the benefits of EU membership with the Turkish-Cypriots. EU ambassadors agreed on April 28th to take urgent measures to end the economic isolation of northern Cyprus. It was decided that northern Cypriot goods could pass freely across the partition line—without the need to prove, as is now the case, that they are of purely local origin. Many EU members would like to open direct air links with northern Cyprus.

At the UN bureau in Nicosia, officials fed fistfuls of documents into the shredder as their “good offices” mission prepared to close. They voiced both disappointment and anger. Mr de Soto's team of experts had painstakingly put together a 9,000-page peace plan which would have enabled a reunified Cyprus to join the EU.

Is there any hope at all that efforts to reunite the island could restart? For many observers, the key lies with Demetris Christofias, leader of the Greek-Cypriot communist party—Akel—which governs in coalition with Mr Papadopoulos. Akel has historically taken a moderate line on the island's future, and Turkish doves were dismayed by its refusal to endorse the plan. While party leaders were willing to do so, many of its supporters were swayed by the emotional rhetoric of Mr Papadopoulos. Something similar happened in the island's centre-right camp, where the leader of the DISY party, Nicos Anastasiades, took a courageous “yes” stance but was clearly ignored by many of his supporters.

So will Greek-Cypriots want to reverse their decision by holding another referendum? It's up to them, say UN officials. But the prospects are by no means bright. Mr Christofias would have to lead the way—and he shows little inclination for a bust-up with Mr Papadopoulos, who has been generous with the spoils of power. Having played the nationalist card successfully, Mr Papadopoulos is riding high at home even as he is shunned abroad.

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German immigration

Brains not welcome here

Apr 29th 2004 | BERLIN
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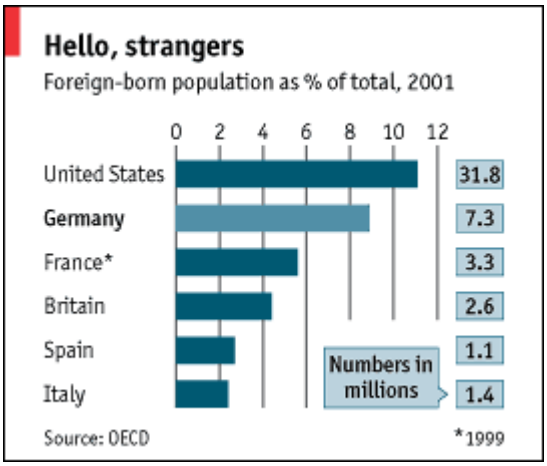
The difficulty of changing a policy that drives talent away

JOSCHKA FISCHER, Germany's foreign minister, knows the world, but sometimes cannot believe his own country. Recently, he met foreign students who had done well at German universities. Many could not work in Germany, as immigration rules stopped them. “Other countries”, Mr Fischer fumes, “would slip a passport to such talented people.”

Sending foreigners home after paying to educate them is not the only contradiction in Germany's immigration rules. Yet, after years of negotiation, the government and opposition are expected to agree on April 30th on a new law that fails to deliver its main objective: to make it easier for qualified foreigners to settle in Germany.

Even more than in other rich places, immigration is a touchy issue in Germany, and it is often exploited to win votes. As many as 7.3m foreigners live in the country (see chart). After European Union enlargement on May 1st, more are expected. For older folk, at least, being German is a question of blood links, which makes integration of non-Germans harder. Generous welfare does not help, as immigrants are often seen as social parasites; nor, for obvious reasons, does Islamist terrorism.



Yet in reality Germany needs more, not less, immigration. Its population is ageing rapidly. Unemployment is high, but by 2020 the western part of Germany will be short of some 2.5m qualified workers. An overly rigid economy would benefit from an influx of highly motivated foreigners to shake things up. And their foreign links could help export-oriented businesses.

For years, conservatives have insisted that “Germany is not an immigration country”. To gloss over this misperception, the country has developed a complex body of immigration law. Hiring workers abroad is banned, save for specific exceptions defined in by-laws. But this has not prevented immigrants from coming in as asylum-seekers, refugees and family members. Instead, it has stopped many of those who would have been most useful.

Things started to change in the late 1990s. The new coalition of Social Democrats and Greens changed the citizenship law, making it easier for immigrants and their children to become German. And it dawned on the country that, in the internet era, it was losing the “battle for the best brains”. The government created a “green card” for information-technology workers and pushed through a law allowing it to pick immigrants more carefully.

Alas, the new policy proved short-lived, not least because of rising unemployment. Having won a majority in the upper house, conservatives demanded changes when the bill, thanks to a procedural error, was re-introduced in parliament. The government scrapped a points system that would have let in highly qualified foreigners without an employment contract. Now only those with a contract are allowed in.

This mess reflects voters' worries about unemployment. In time, Germany must adapt to reality. Thomas Straubhaar, president of the Hamburg Institute of International Economics, argues that the present rules signal that this is one of the less open countries in an increasingly global marketplace. The world's best

brains will surely take note—and go elsewhere.

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Russian reform

Slaying his own dragons

Apr 29th 2004 | MOSCOW
From The Economist print edition

Vladimir Putin has identified bureaucrats as his new foe

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AP

Putin girds for battle

DURING his first term in office, Russia's doughty president subdued one formidable opponent: the country's business elite, the rich and powerful "oligarchs". Now he is taking on an even more intractable foe—the foot-draggers, time-servers and other rogues who notionally work for him. That, at least, is the version of history that Vladimir Putin is propagating.

True enough, the oligarchs did have great influence over Mr Putin's predecessor, Boris Yeltsin. A long-running investigation into Yukos, an oil company, is seen as punishment of its now-jailed boss, Mikhail Khodorkovsky, for getting too big for his boots during the Yeltsin years. This week there were signs of an imminent peace deal when Yukos (which could face bankruptcy after the government hit it with a $3.5 billion tax bill, and a court then froze most of its assets) invited Viktor Gerashchenko, a former central bank governor, to be its chairman. Whatever the outcome of the Yukos affair, the energy sector as a whole is certain to face higher taxes: the Duma, egged on by Mr Putin, has just set rates for a windfall tax on oil companies' profits which could rake in an extra $3 billion in revenue in 2005.

So much for the battle with business. But the fact Mr Putin now presents the bureaucracy as an enemy might seem strange; after all, it has grown under his rule, particularly in his own presidential administration. But more than once recently, he has railed against bureaucratic obstructionism. Shortly before his re-election in March he fired Mikhail Kasyanov, the prime minister, who was not only the oligarchs' biggest ally but an obstacle to a long-planned administrative reform. With Mr Kasyanov gone and the plan's main architect, Dmitry Kozak, installed as cabinet chief of staff, it may be possible to proceed as originally hoped.

Various ministries have already submitted plans for staff cuts, due to start taking effect after Mr Putin's re-inauguration on May 7th. Mr Kozak himself announced this week that he will fire more than a quarter of the 1,000 staff at the White House, the government headquarters. Across the board, the government should shrink by 20%. The money saved will go towards multiplying senior officials' salaries (Mr Putin's included) by anything from two to 12 times, to reduce temptations for corruption. The government is being rearranged along lines first thought up in 1997 under Mr Yeltsin: fewer ministers and a separation of powers between ministries (which set policy), "agencies" (which implement and manage) and "services" (which enforce and regulate).

But how reality will match the plans is still anyone's guess. INDEM, a think-tank that studies corruption, say that the ministries will be in control of the agencies and services instead of equal to them as was envisaged in the 1997 plan; this will undermine the idea of accountability. To take one example—with the statistical service subordinate to the economics ministry, will it really resist the temptation to massage economic data? And will officials really be fired, or merely re-designated in a personnel-juggling trick?

Moreover, a reallocation of roles inevitably means fights for the choicest ones. Officials within the culture and media ministry are already slugging it out over which department gets the job of granting broadcast licences, an enormous lever of power. Such battles—a predictable consequence of dismantling the old structure before deciding what to put in its place—could last for months; and there is no knowing what

weak links and special interests the new system could end up with.

The toughest job of all will be to overhaul the so-called “power structures”: the police, prosecutors and army. So far, there are no concrete proposals, other than Mr Kozak's stated intention of reducing the powers enjoyed by prosecutors. As for the army, the generals blocked military reform during Mr Putin's first term, and the ensuing deadlock remains unbroken.

But there was one hint this week that Mr Putin is not completely beholden to would-be skull-crackers. He suggested watering down a draconian bill now going through parliament which would have sharply restricted public gatherings. Although the president is more powerful than ever, he gives the impression he still listens when there is a big outcry.

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Charlemagne

A party spoiled?

Apr 29th 2004
From The Economist print edition

For EU old-timers, new guests could wreck the feast

IS IT a dining club, a cocktail party, a coterie or even a cabal? Almost everybody who sets out to describe the European Union to a bewildered world uses images drawn from exclusive forms of social life or entertainment. And as every caterer knows, the key to a successful social event lies in estimating numbers correctly, and adapting the refreshments accordingly. So with ten new guests donning their evening clothes to join the existing 15 at the EU's never-ending gala, and several others looking on hungrily, the party planners of Brussels wonder if they can cope.

When the process of European unification began in the 1950s, the early meetings were marked by an easy-going, first-name intimacy. With just six countries involved, the atmosphere did resemble an up-market dinner party with a bit of politics thrown in. But as the club expanded to nine members, then ten, then 12 and then 15, things became more formal. For the past few months, the EU has already been meeting with 25 countries around the table—and early reports are not encouraging.

One EU veteran laments that the new Union no longer feels like a family and instead is beginning to resemble the UN or any other big, international organisation. Shortly before stepping down, the Spanish prime minister, José María Aznar, told *Le Monde*: “It's been a long time since we discussed things really in depth between European leaders. In recent times [at European summits] we have talked about virtually nothing.” This is hardly surprising: if all 25 leaders make an opening statement, it takes an hour and a half before discussions even begin.

The day-to-day business that keeps the EU running is conducted by specialist ministers meeting in councils that deal with everything from agriculture to foreign policy. These meetings, too, have become much harder. Each minister may have at least a couple of advisers; add in all the EU officials and there can be more than 100 people in the room. “EU meetings are absolutely atrocious now,” groans a senior French official. “Nobody would ever say anything remotely confidential at an EU meeting any more”, says a Briton. “You might as well go outside and shout it through a megaphone.”

The disparity in member states' size and power adds to the sense that EU meetings are becoming a charade. Nine of the ten new members that join the Union on May 1st have populations of less than 10m. Yet diplomatic niceties dictate that Gerhard Schröder, chancellor of Germany with a population of 82m, can be treated no differently in EU meetings than Lawrence Gonzi, prime minister of Malta, with a population of 397,000.

One might expect bigger countries to lead the discussions. But at recent summits the interventions of Mr Schröder, Tony Blair and Jacques Chirac have been brief. “They are trying to set an example to the others so that the meetings do not go on for ever,” comments one EU official. Or perhaps they now feel that important business cannot be conducted in formal EU meetings: it is best done at looser, smaller gatherings.

The emergence of a *directoire* of big countries is precisely what the small members of the EU fear most. They howled when the British, German and French leaders staged a three-way summit in Berlin in February. Less noticed—but perhaps more significant—is the emergence of a group of home-affairs ministers from five larger EU countries who meet to co-ordinate policies on issues ranging from immigrants to terror.

Together, the ministers from Britain, France, Germany, Italy and Spain represent around 300m of the enlarged EU's population of 455m. The big five's ministers naturally continue to turn up for the meetings of all 25 EU justice ministers. But they may increasingly feel they are liable to get more done in the smaller formation of ministers from big countries. Purists might expect the European Commission to crack down on such ad-hoc arrangements. Instead it seems inclined to take a pragmatic attitude. One senior official comments: “There is nothing quite like this in other policy areas yet, but the practice is likely to spread. Caucuses could well be the future in an EU of 25.”

A nobler image needed

Such a development is bound to cause bitterness and suspicion among smaller countries. And the bitterness could flow both ways, if the bigger states begin to feel that important EU policies are being blocked by minor veto-wielding states. The decision of Greek-Cypriots to vote against the EU-endorsed plan for a peace settlement last week shows just how this might happen. It has led to fears that the Union's decision on whether to start entry negotiations with Turkey—a critical strategic choice—could now become hostage to about 700,000 Cypriots.

So the potential problems associated with enlargement go well beyond the practical headaches of trying to run meetings in Brussels. But there are also potential benefits, of far greater moment than the “catering” problems which are worrying EU insiders. People struggling to make the EU work on a daily basis are prone to lose sight of the big picture, and to take for granted the huge benefits that enlargement could bring the EU—freer travel, faster growth, more stable and peaceful societies.

Robert Schuman, a French foreign minister of the 1950s and a founding father of European unity, always insisted it was the role of western Europe to serve as a beacon of hope to countries trapped on the wrong side of the Iron Curtain. As he put it: “We must construct Europe not only in the interests of the free peoples, but also to welcome in it the peoples of eastern Europe, who freed from their repression will ask us for their adhesion and our moral support.”

If the European Union could somehow recapture that spirit of generosity—and open-ended hospitality—it might be able to imagine itself as something a bit nobler than a perpetual feast for the already well-fed, where newcomers are a headache for the chefs and seating planners.

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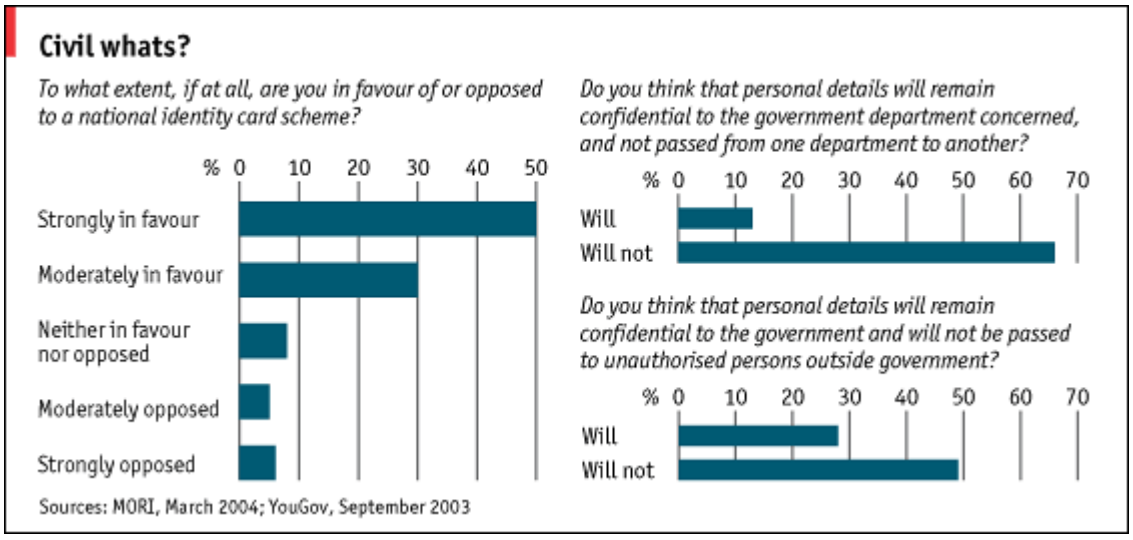
Identity cards

Will they work?

Apr 29th 2004
From The Economist print edition

A national identity card is unlikely to deliver all the things expected of it

BRITONS like to think of themselves as plucky individualists, resistant to authoritarianism both foreign and domestic. It's a self-image that is becoming increasingly difficult to sustain. This week, David Blunkett, the home secretary, unveiled a draft bill that, if enacted, would create the most ambitious and intrusive national identity card scheme in Europe. For many, the only complaint was that it was long overdue.



Over the past decade, opinion polls have consistently shown 75-85% in favour of ID cards. Oddly, people want them even though they don't trust the government with personal information. MORI, a pollster, reports that just 10% are “very confident” their details would be kept secure. A YouGov poll carried out last September found that two-thirds didn't trust civil servants to keep information from one another, while half suspected they would share it with outsiders. Clear majorities also predicted disruption, inconvenience, and a rash of forgeries.

This puts unusual pressure on the scheme. Britons want cards to help stop illegal immigrants from working or using public services, and to fight terrorism and reduce fraud. They will compromise on personal privacy because they reckon the system will deliver on these things. Will it?

The government's plans are certainly ambitious. Starting from scratch, it wants to build a central register that will hold the name, date of birth, current and former addresses, nationality, passport number and national insurance details of everybody residing in the country longer than three months. The register will also record every occasion on which this information is accessed or changed, and by whom. Keen citizens will be able to add more to the register if they find this insufficient.

More ambitious still are plans to link the register to other government databases, and to incorporate biometrics such as fingerprints and iris scans. This is handy for deterring forgers, but it raises the price and complexity of the system well above anything that exists, or is being contemplated, elsewhere in Europe.

Building a secure ID-card system is not difficult, says Richard Barrington, head of government affairs at Sun Microsystems. The real problems (and the costs) arise elsewhere: in collecting people's images or

iris patterns, “binding” these to paper documents such as driving licences, and managing the system so that false and multiple identities are expunged. “If this is not done in a disciplined way, the register will become like every other government database—that is, full of junk,” he says.

This becomes exponentially more difficult as the job progresses. On the current, rather relaxed timetable for building the register (a pace forced by cabinet sceptics), it will capture about 80% of the economically active population by 2013. Then comes the challenge. The final 20% includes people on the fringes of society—those who do not work legitimately, drive, vote, or hold British passports; in other words, precisely the sort you would want in a database. Capturing them will be desperately difficult, despite a proposed £2,500 ($4,500) fine for non co-operation.

A larger problem is one of function creep. There is likely to be pressure, not just from politicians but also from convenience-minded citizens, to make the card do more. Data will inevitably be added to the register, and (as MPs have themselves hinted) companies will make increasing use of it to check identities. The problem, say security engineers, is that the more uses for a card, the more rapidly it degrades. Even in Belgium, which has had compulsory identity cards since 1919, social-security information is kept on a separate bit of plastic.

Those lonely souls who worry about the erosion of civil liberties might take comfort from the fate of the various “smart card” schemes already in existence in Britain. The most ambitious one was launched three years ago, in Southampton. By now, every resident was supposed to have a card, which would allow access to, and payment for, a wide range of council services. Electronic voting was mooted. But it proved difficult to get banks, transport operators, or even council departments on board. Today, the card is used mostly to check out library books and get into leisure centres.

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Britain and the Middle East

Angry ambassadors

Apr 29th 2004
From The Economist print edition

Fifty-two former diplomats can't be wrong, can they?

ON APRIL 26th, 52 former British diplomats cast aside the discreet habits of their working lives and sent an open letter to Tony Blair, criticising his Middle East policy. Civil servants tend to be proud of their political neutrality, which normally extends into retirement. Most also think they should avoid interfering where they no longer have responsibility, for fear of making their successors' jobs tougher. Breaking this code, at a time when British and American troops face problems in Iraq and the prime minster looks less authoritative at home, has given the letter an impact that surprises even the ex-dips.

The letter attacked Mr Blair for not pushing George Bush harder on the “road map” for Israel and Palestine, and for seeming to endorse new policies, announced by Mr Bush and Ariel Sharon, Israel's prime minister, “which are one-sided and illegal”. On Iraq, the letter accused Mr Blair of not providing an effective post-war plan. It also said the belief democracy could be created by the coalition was “naive”.

The letter was drafted by Oliver Miles, a former ambassador to Libya. It originated within a group of specialists who e-mail each other regularly about the Middle East, and who decided to air their grievances after Mr Blair's trip to Washington earlier this month. The list of signatories does not include anybody who has been our man in Washington. It does, however, include Francis Cornish, a former ambassador to Israel, and Sir Crispin Tickell, former envoy to the United Nations in New York. Most of those who signed up thought the war was a mistake from the outset, although some supported the invasion to topple Saddam Hussein.

If Mr Blair had hoped that so much collected experience would present him with a plan B, he must have been disappointed. The letter took him to task for getting into what even his supporters admit is an exceedingly difficult position, but offered no advice on how to get out of it.

So what was the letter meant to achieve? The diplomats say they wanted to influence government policy and to strengthen the position of like-minded officials in the Foreign Office and the American State Department, some of whom apparently feel, like Mr Miles, that the problems in Iraq were “not just foreseeable but were foreseen”. It could, however, have the opposite effect, if it sharpens Downing Street's suspicion of the Foreign Office's traditionally Arabist tendencies.

Publicly, the government has ignored the letter—as it did similar criticisms last week from another pillar of the establishment, Rowan Williams, the Archbishop of Canterbury. This is unlikely to outrage the voters. In the public mind, a faint aura of absurdity surrounds ambassadors. That may be something to do with an anachronistic grandeur unmatched by contemporary usefuless, and something to do with a long-running and painfully kitsch advertisement for Ferrero Rocher chocolates set in an ambassadorial reception.

Anyway, precedent is on Mr Blair's side. In 1981, 364 economists signed a letter to Margaret Thatcher telling her that her economic policies would lead to disaster. They wrote just at the moment the economy turned up.

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Extremism

Brutes in suits

Apr 29th 2004
From The Economist print edition

The international alliance of xenophobes

Get article background

FOREIGNERS, in the lexicon of the whites-only British National Party (BNP), are not welcome here. It wants priority for whites in jobs and housing, and voluntary (at first) repatriation for non-whites. That simple racist stance has helped it win a total of 15 council seats, which it hopes to increase in local elections next month. If votes for other parties split the right way, the BNP may just win a seat in the European Parliament in June.

Reuters

Reservoir frogs

But for some foreigners, the BNP puts its xenophobia on hold and tries to be nice. This week it invited Jean-Marie Le Pen, leader of the BNP's much more successful French counterpart, the National Front. He may have been glad to get home: protesters pelted his car with eggs and rocks, and he had to endure a dinner featuring the BNP's idea of traditional British cooking: Welsh vegetable soup, roast beef and apple pie.

Nevertheless, the attempt to look part of a big successful international family didn't work. The BNP tends to attract the sort of people who greet foreigners with kicks, not handshakes.

That highlights a fundamental problem for a party that is trying to portray itself as intellectually respectable, but relies on a core of members notorious for their thuggery and nuttiness. The BNP'S senior figures include people who have served prison sentences for offences including rape, assault, robbery and football hooliganism. Others deny the Holocaust, collect Nazi memorabilia, and like writing their names in runes.

Even when the BNP wins elections, it fails to use them to promote its ideas. Its councillors are rarely seen, inarticulate and quarrelsome: in Burnley, the party's stronghold, one councillor had to resign after hitting a party colleague with a beer bottle. More electoral success for the BNP is not a nice prospect, but there will be some black humour to it.

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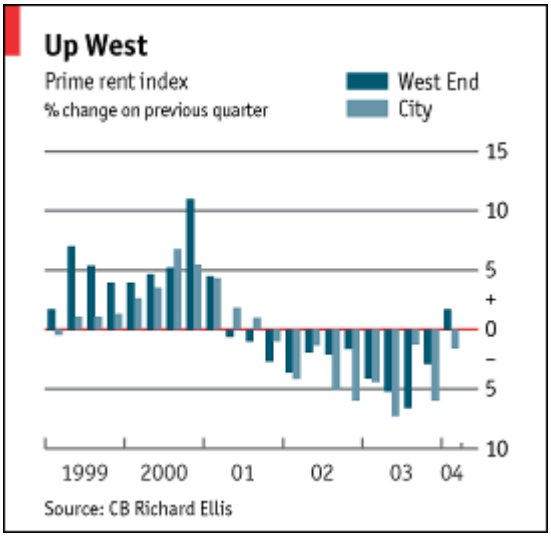
London office rents

Better times

Apr 29th 2004
From The Economist print edition

After three grim years, the West End is leading London's office rents back up



LAST Monday's mail brought shareholders in Canary Wharf plc, the company that owns most of that giant office development in London's ex-docklands, two bids: one at 295p a share in cash, and a rival bid which in its all-paper version was claimed to be worth 348p. A year ago the shares fetched about 160p. And the long takeover battle has not been just stockmarket madness. More space was let at Canary Wharf in the first quarter of this year than in all 2003. Royal Bank of Scotland bought two buildings there for £1.1 billion ($1.9 billion). In Canary Wharf and London's two main business districts, the City and the West End, the three-year gloom in London's office market is over.

The recovery won't match the boom-bust follies of 1987-92, when rents shot up 40-60% in a year and five years later were falling almost as fast. Vacant space is down some 2m square feet from last year's 26.5m peak, but landlords still have to offer such inducements as the now familiar two-year rent holiday on a 10-15-year lease. Some big buildings are still empty or, like Swiss Re's famous “gherkin” in the City, only half-let. Other buildings will be completed soon, and though there aren't many now under construction to follow them, Gordon Brown's determination to shift civil-service jobs out of London will dampen demand in the years ahead.

But an upturn has started, and is faster than many foresaw. Four months ago, one fund manager predicted City rents would fall by 15% this year, nearly as bad as last year. Even optimists expected to wait two years for a recovery. Yet figures from CB Richard Ellis, a leading agent, now show only a 1.5% quarterly fall in the City in January-March, while West End rents actually rose, for the first time in three years.

Why is this? Confidence has returned to business generally and financial services, the mainstay of the City and Canary Wharf, in particular. The moneymen are not hiring in large numbers, but they are ready to upgrade. Lehman Brothers recently moved to Canary Wharf; Barclays will do so in January; Reuters will follow. A year ago, Canary Wharf plc had to admit that, to get certain tenants in, it had agreed they could hand back space that they found they did not need. It had 800,000 sq ft dumped on it. Now CSFB, an investment bank, which had put 225,000 sq ft on the market, has withdrawn it.

The City too has high hopes. Willis Group, insurance brokers, is about to sign up for a 410-foot-high

skyscraper. It will tower above the Lloyds building—yet look puny beside three 700-foot-plus City monsters that are planned, let alone the “shard of glass”, 1,016 feet of it, just across the Thames by Tower Bridge.

Yet the big news, rent-wise, is in the West End. Lazard, an investment bank, moved to Mayfair from the City in 2002. Hedge funds and venture capitalists have multiplied nearby, and less development has kept supply in check. In the City, the rent asked for either of two elegant new low-rise developments next to St Paul's cathedral is about £50 a square foot; in the West End, that for a seven-storey development of much the same size on Park Lane is £70. That was the asking price last autumn, when a property man said “they'll maybe get £60”. Today, the first tenants are said to be close to signing up, if only for part of the building, at £70-plus.

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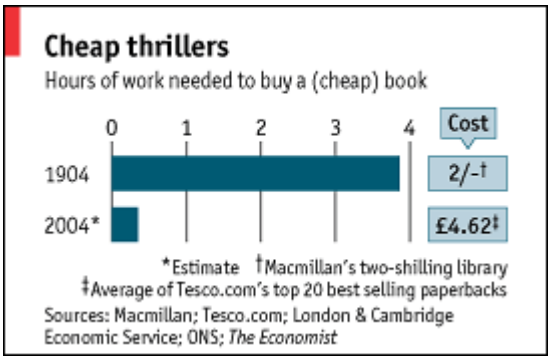
Public libraries

End of story?

Apr 29th 2004
From The Economist print edition

Why fewer visits to the library are partly good news

PUBLIC libraries will be redundant by 2020 on current trends, according to a new report by Tim Coates for Libri, a charity that worries about such things. Mr Coates, a former managing director of Waterstone's, a chain of book stores, also says that though spending on libraries is up, visits have declined by 21% and numbers of books borrowed by 35% in the last ten years, making a once public-spirited enterprise bad value for public money. The libraries' sad state is being interpreted as a symptom of modern philistinism. But their decline is the consequence of a happy tale.



The first public libraries were established in 1850, for the same reasons as the Public Health Act of two years earlier. Paternalists wanting to improve the minds and bodies of the working classes had another hit in 1919, when a second act gave power over libraries to counties, spreading their benefits further from the metropolitan centres where they were first built.

But the falling price of books sent libraries into a decline. Over the long run, books have become much more affordable (see chart). The first blow was the introduction of the sixpenny Penguin in 1935; the second, the end of the net book agreement in 1997. Since then, both sales and variety have increased. About 280m books were bought in 2003, an increase of 20% since 1997. And in 2002, just over 125,000 new titles were published, or one new book for every 470 Britons.

Recent attempts to make libraries more visited include filling them with easier forms of entertainment (why read the book when you can watch the DVD?) or computers with internet access. But those, too, are increasingly affordable and therefore available at home. For libraries, it may indeed be the final chapter.

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Exams

Why A-levels fail

Apr 29th 2004
From The Economist print edition

Depreciated exam results make new academic currencies attractive

Get article background

INFLATION interferes with price signals. That's true for both money and exam results. Around a fifth of all A-level candidates get an A grade. The situation is even worse than it appears: in difficult subjects, As are awarded particularly freely—to 40% of maths candidates, for example.

Arguments rage about the reasons. Critics say that the exams have become easier, and that the system has been further tweaked to encourage students to study subjects that might otherwise be dropped as unrewarding. Government cheerleaders say that the exam results reflect better work by schools and students. It is also argued that A-levels should mainly be about teaching teenagers interesting and useful things, rather than acting as a ready-made filter for higher education.

But, as the current row over A-grade students being refused university places shows, A-levels work increasingly badly as a way of sorting the bright from the average. Some dons, faced with a flood of undifferentiable As, have given up any pretence of rational selection. Leeds Metropolitan and Huddersfield universities, which have 20 applicants for each physiotherapy place, are choosing successful candidates randomly from a pool of those with the right grades.

The government is considering reforms. One possibility is publishing precise percentage marks instead of grades. The trouble is that candidates from independent schools do disproportionately well. Percentage marks would show that up even more starkly, and undermine attempts to get more youngsters from state schools into the best universities. Other possibilities may emerge from the review of 14-19 education that is under way.

In the meantime, some universities are taking the matter into their own hands. In medicine and veterinary science, two of the most competitive subjects, six of the top university faculties now select through a new Biomedical Admissions Test. Last year, 3,000 applicants took this; next year 5,000 will. Eight law schools are now following suit, with a legal aptitude test. Cambridge sets extra maths and science tests for applicants to those courses.

These are, in effect, multiple academic currencies. Inevitably, this increases transaction costs. The best-taught students—who tend to be from private or selective state schools—will cover them most easily.

Yet an existing exam is supposed to solve this problem. The Advanced Extension Award (AEA) uses the same syllabus as A-level, but asks more demanding questions. Introduced in 2002, take-up has risen to 7,200 last year, with a further increase expected for 2004. Some universities, including Cambridge and Birmingham, already look kindly on applicants with AEAs. More will follow in 2006, when AEA results are formally included in the national applications system. A return to a single currency would be welcome.

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BT

Will BT do the splits?

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BT does not want to be split in two, but it might benefit

JUST a week after running the rule over public-service broadcasting, Ofcom, Britain's new communications regulator, has delivered the initial phase of a comprehensive review of Britain's telecoms market—the first of its kind for 13 years. Last week the BBC was left wringing its hands. This week BT is.

Although this preliminary part of the review sets out to ask questions rather than to answer them, Britain's incumbent telephone company will take little comfort from that. Only one of the five questions is explicitly concerned with BT's present structure, but it is difficult to think about some of the other issues, such as the future of broadband services, without considering the impact of BT's still considerable dominance. As a senior Ofcom staffer puts it: “When you have an elephant sitting in the room, it's a good idea not to ignore it.”

The issue for Ofcom is whether by splitting up BT (structural separation, as it is known in the industry's jargon) it can foster a market which will provide consumers with more services and lower prices, which, in turn, could be expected to provide a fillip for the whole economy.

Nineteen years after the first tentative steps towards liberalisation, BT still has 60% of the domestic retail market, 73% of the residential fixed-line market and getting on for 90% of the wholesale market. Even more disturbingly, thanks to its stranglehold over the network, BT has been able to win 50% of the retail broadband market. Critics say it has done so through a combination of delaying tactics designed to frustrate would-be competitors from installing their equipment at BT's exchanges and discriminatory wholesale pricing.

Although BT divided its retail from its wholesale business a few years ago, competitors such as Centrica, a utilities retailer spun off from British Gas, complain that BT Wholesale punishes service providers who compete with the retail business. This, it is claimed, has discouraged companies from introducing new services and allows BT Retail, which made profits of £1.6 billion last year, an unfair advantage. Presenting this week's report, Stephen Carter, Ofcom's chief executive, said the fees rival operators pay are “significantly adrift of European best practice”.

BT, unsurprisingly, is not keen on being split up. But some argue that BT's businesses and its shareholders might benefit from enforced de-merger. Currently, BT Retail is heavily regulated and BT Wholesale is at times constrained by BT Retail's interests. When British Gas was broken up eight years ago, not only did consumers benefit from lower energy prices, but all three separate businesses have flourished.

Ofcom insiders say it does not yet even have a “working hypothesis” about what should happen to BT. Much, they maintain, will depend on how BT conducts itself between now and publication of the strategic review's conclusions before Christmas. They also pay tribute to BT's newish chief executive, Ben Verwaayen, and the team he has recruited: unlike their predecessors, “they are at least strategically competent”. Mr Verwaayen may also be persuaded that it would be better to keep the firm's destiny in its own hands than be at the mercy of the regulators.

He would be wise to prepare for the worst. Shortly before his appointment as Ofcom's chairman in 2002, Lord Currie, an economist, published a paper about Britain's telecoms market that caught the government's eye. In it, he indicated he was in favour of a break-up.

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Public-service productivity

Bangs and bucks

Apr 29th 2004
From The Economist print edition

Ministers challenge figures showing big losses in government efficiency

EVER since the government started shovelling money into the public services, it has been vulnerable to the charge that much of it is being wasted. Embarrassingly, that is precisely what official figures seem to show.

The national accounts show a growing divergence between the amount of money spent on the public services and the output this has produced (see chart). In the past two years, for example, cash spending rose by 21%, but the volume of output increased by 4%.

Much of the extra money has gone on rising public-sector wages and more costly purchases from the private sector. But a study by the Office for National Statistics (ONS) last year revealed that inputs, after adjusting for inflation, were rising faster than output. As a result, productivity—the ratio of output to real inputs—fell by 3% from 1997 to 2001. No subsequent estimates have been published, but according to the *Sunday Times*, a cabinet-committee document says that productivity has now declined by 10% since 1997.

The government's response to the dire figures for productivity and output has been to question the way they are calculated. Sir Tony Atkinson, warden of Nuffield College at Oxford University, has been asked to review the issue. He is due to present a preliminary report in July.

Measuring government productivity is undeniably hard. Capturing improvements in the quality of public services is especially tricky. If doctors spend longer with patients, patients will probably like it and may get better quicker, but a simple measure will show a fall in productivity.

Because of such problems, statistical offices used to assume that government productivity stays the same: the volume of output equals real inputs. Many still use this approach, but the ONS has pioneered independent estimates which cover about 70% of government output.

Ministers believe that the new ONS methods are defective. For example, educational output is estimated using the number of pupils, weighted by cost. Gordon Brown, the chancellor, points out that productivity measured this way will decline when class sizes fall even though this is likely to raise the quality of

teaching.

John Reid, the health secretary, believes that the ONS figures, which focus on hospitals and doctors, do not capture changes that are making health care more effective. These include the shift from stays in hospital to cheaper nurse-led treatments in out-patient clinics and the introduction of new services like NHS Direct, a medical advice line. The productivity measure does not take account of improvements in quality, says Nigel Edwards, policy director of the NHS Confederation.

Such criticisms suggest that government productivity has not declined as alarmingly as the latest reports indicate. But whatever the outcome of the Atkinson review, other evidence suggests blockages in translating extra money into better public services. In education, improvement in the results of 11-year-olds has ground to a halt. In health, a recent survey by the OECD found “few indicators showing unambiguous improvements in outcomes over and above trend improvements that were already apparent before the surge in spending”.

Labour's decision to become a big spender was a risky one. However the official figures are reconfigured, the government is open to criticism that it has spent too much delivering too little.

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Forgotten assets

Dormant accounts: a rousing dispute

Apr 29th 2004
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Billions of pounds lie unclaimed in forgotten accounts

YOU will never find a £10 note lying on the pavement, economists confidently predict, because someone else will have already picked it up. But more substantial sums than this are left lying in Britain's bank accounts, unclaimed by forgetful, careless, or deceased depositors. HSBC, for example, is reputed to hold about £400m in such “dormant accounts”. But HSBC, which lets its sleeping accounts lie, has been one of the few banks to disprove economic theory. Many of their competitors, including Abbey, Barclays and Royal Bank of Scotland, have been diligently picking up these unclaimed sums and pocketing them as profits.

Martyn Jones, Labour MP for Clwyd South, is outraged by this revelation, first reported in the *Financial Times*. In a BBC interview, he accused the banks of “stealing by finding”. The charge is a little strong. A person is guilty of stealing what he has found only if he does not try to locate the true owner—and the banks have tried. Besides, banks did not literally stumble upon this money in the street. It was entrusted to them by account-holders who now neglect to answer their letters.

Nonetheless, Mr Jones is making headway in his campaign to have dormant accounts handed over to charity. In this year's budget, Gordon Brown, the chancellor of the exchequer, said that assets which could not be reunited with their owners should be “reinvested in society”. The government is impatient for the banks to come up with a voluntary scheme of their own. If they have made no progress by November, it says it will legislate.

The Irish government has already done so. In April of last year, accounts worth €196m (£136m) were handed over to a dedicated agency, the Dormant Accounts Fund. Some €10.3m was subsequently reclaimed by its original owners; but much of the rest will be invested over time in projects to tackle urban blight, illiteracy and drug abuse, among other things.

A similar scheme in Britain might reap even greater riches. Britain's retail deposits are at least ten times as large as Ireland's, after all. And Gordon Brown will relish his bank raid for the good of society.

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Bagehot

A question of identity

Apr 29th 2004
From The Economist print edition

Which is the real David Blunkett? An authoritarian bully or man of the people?

NO MINISTER in this government divides opinion quite as sharply as David Blunkett, the home secretary, who this week launched his plan for a national identity card scheme. For some, he is a dangerous populist who consistently demonstrates his contempt for civil liberties, the law and the judges who uphold it. For others, he is an impressively strategic politician who understands that democracy depends on the ability of government to connect with and respond to the fears and concerns of ordinary people. What nobody denies is that Mr Blunkett has thus far overcome every obstacle that life has placed in his path, including blindness from birth.

Mr Blunkett cheerfully says he is putting his “head on the block” by forging ahead with ID cards (see article). Although he has the enthusiastic support of the prime minister, some other cabinet ministers, including the powerful pairing of the chancellor, Gordon Brown, and the foreign secretary, Jack Straw, are sceptical if not downright hostile. Civil liberties groups are predictably outraged, while sophisticated opinion sees it as further evidence of Mr Blunkett's capacity to combine an unhealthy authoritarianism with headline-grabbing initiatives that too often end in administrative cock-up. A lot of people are hoping that even if Mr Blunkett keeps his head, he will still end up with egg on his face.

How much of a risk Mr Blunkett is really taking is questionable. He must take the doubts of cabinet colleagues seriously, but positively relishes the attacks from other quarters. The people are on his side. In a MORI poll conducted in March, four out of five said they would willingly carry an ID card at all times and three out of four were at a loss to discern any threat to their personal liberty. If ID cards can help make identity theft, benefit fraud, illegal immigration and terrorism all a bit harder, most people are more than happy to sign up for them. What better demonstration could there be of the gulf between Mr Blunkett's detractors and the people he sees it as his job to represent?

It is this belief more than any other that fuels his continuing battle against the legal establishment. Last week, Mr Blunkett got himself into trouble, not for the first time, by reacting with undisguised incredulity to the decision of the Special Immigration Appeals Commission to release on bail an Algerian, known as “G”, who, the court accepted, had helped terrorists. The court decided that although “G” was quite probably a danger to the country, the possibility that his unlimited incarceration was making him mentally ill mattered more. Mr Blunkett said that many people would regard what had happened as “bonkers” and was promptly rapped over the knuckles by Lord Donaldson, a former Master of the Rolls and no admirer of the home secretary, for “being rude to the referee”.

Mr Blunkett should perhaps choose his words more carefully. Some people were horrified when he said that his first reaction to the news that Harold Shipman, Britain's most prolific multiple murderer, had “topped himself” in jail was “to open a bottle”. However evil Shipman was, home secretaries should not welcome prison suicide. But for all his occasional intemperance and willingness to shoot from the lip, there is a serious purpose to most of the things that Mr Blunkett says and does.

Mr Blunkett is one of only two indubitably working class members of Tony Blair's cabinet (the other is John Prescott, the widely ridiculed deputy prime minister) and he feels a duty to speak on behalf of the slice of society he came from. As education secretary he took on teachers who preferred progressive theory to ensuring children from disadvantaged homes left school with the literacy and numeracy they needed to escape poverty. And now, as home secretary, he is waging a different, and in some ways far more difficult, campaign against what he sees as the criminal justice system's failure to fulfil the most basic duty of the state: to protect the law-abiding majority from the criminal minority.

As he put it shortly after becoming home secretary in 2001: “My views are informed by my everyday

experiences of life in Sheffield, of talking to my constituents and my community. They, and thousands like them round the country, are the real stakeholders. Ministers and the legal profession are nothing without their active support and participation: at the ballot box; as taxpayers; as community activists; and in upholding rights and living up to responsibilities in their everyday lives."

It's the poor what pays the price

Mr Blunkett believes that for all the liberal hand-wringing over the prospect of an over-mighty state assaulting both ancient liberties and the newer ones that have been incorporated into British law from the European Convention on Human Rights, more lives are blighted by the erosion of authority than by its extension. Poor people see more clearly and feel more deeply than the rich the effects of illegal immigration, abuse of the benefit system, anti-social behaviour that goes unchallenged by the police and a criminal justice system that sometimes seems to be a conspiracy against victims.

Some of Mr Blunkett's critics argue that even if this is so, he should do more to reassure and less to pander to *Daily Mail* prejudices. His reply is that unless you address people's insecurities and express them in language to which they can relate, they will not hear the wider message about what should constitute a civilised society. Mr Blunkett has indeed talked eloquently about the benefits of "managed immigration". Similarly, his attempts to apply some common sense to Britain's self-defeating drug laws, reform the creaking prison system and widen the use of alternatives to custody do not exactly suggest an illiberal bigot.

So, democrat or populist? The dividing line is a narrow one—perhaps narrower than Mr Blunkett cares to admit.

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Correction: British mortgage debt

Apr 29th 2004
From The Economist print edition

Last week we said British mortgage debt was £800m. That should have been £800 billion. Sorry.

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Arnold's big chance

Apr 29th 2004
From The Economist print edition

AP

Something remarkable might just be happening in California. Not before time, says John Micklethwait (interviewed here)

IT IS a warm March evening in a plush Santa Monica hotel, and you could be forgiven for thinking it is politics as usual in America's least governable state. The celebration is to mark the passing of two debatable pieces of direct democracy: Proposition 57, which will postpone the budget crisis with borrowing of $15 billion; and Proposition 58, which purports to oblige the legislature to pass balanced budgets in future. On the podium stands a triumphant group of unknown state politicians and lobbyists.

In fact, this is anything but politics as normal. One clue is the rope needed to hold back a throng of journalists—an oddity in a city where on the local news state politics usually comes after the sport and the weather. Another is the remarkably heterogeneous line-up of supporters on the dais: ultra-conservative Republicans and ultra-liberal Democrats, tax-cutters and government bureaucrats, the chamber of commerce and trade unionists. In February, support for the propositions was running at barely 30%. Yet after a systematic campaign by the new governor, the two measures were approved by large margins.

Eventually, the reason for this abnormality comes bounding on to the stage in a dapper cream suit. “I love it when voters flex their muscles,” beams Arnold Schwarzenegger. After a brief pep talk, he pumps his hand in the air, and the room fills with music: U2's “A Beautiful Day”. On cue, the curtain behind him drops to reveal a slogan: “California is back on track”. Except there is a hitch: the middle part of the curtain fails to drop, obscuring the new message until some frantic tugging backstage brings it down. The governor leaves without taking any questions.

To many outsiders, the election of the erstwhile cyborg last October was a childish state's act of advanced political immaturity. Only 11 months earlier the state had comfortably re-elected Gray Davis, its Democratic governor. Then it changed its mind, tossing Mr Davis out in a bizarre recall election which Mr Schwarzenegger entered at the last possible moment. There followed a campaign too brief for the star-struck state to go into a flurry of accusations about the actor's past “playfulness” (as he put it) with women, let alone discover where he stood on a range of issues. “Ah-nuld” romped to a massive victory.

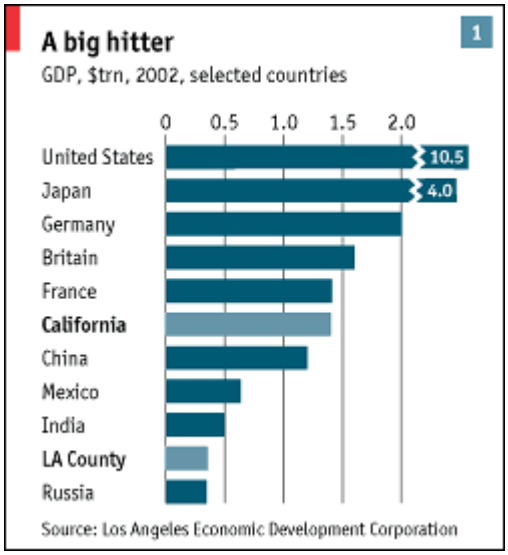
At first sight, California's choice seems laden with risk. However, this survey will argue that the Schwarzenegger governorship actually offers the state its best chance of serious structural reform for at least a generation. In part, this judgment is a mild vote of confidence in Mr Schwarzenegger: for all his

obvious political frailties, the gubernator represents a particularly potent form of centrist Republicanism. Far more important, though, the judgment is about California itself—a place of enormous talent, despite the mess it has got itself into.

California matters

Ever since an 1848 newspaper article alerted the world to nuggets of gold in a stream in the foothills of the Sierra Nevada, the world has marvelled at the 800-mile-long sliver of land by the Pacific, and tried to get there. The first pioneers scrambled over the Sierra Nevada, leaving stragglers behind; the newer arrivals sneak across the desert border, paying *coyote* gangs to smuggle them in. After the gold came farming, then oil, movies, aerospace, computer chips, the PC, biotechnology, nanotechnology, topless shoeshines, chocolate zucchini cake, the Church of Scientology and much else besides.

The result is a miracle of private enterprise. In 2002, some 35m Californians generated a gross state product of $1.4 trillion, making theirs the sixth-largest economy in the world. If Los Angeles County, home to 10m people, were a separate country, it would be the 16th-biggest economy in the world, just above Russia (see chart 1). And it is not just a question of size, but of influence. As the poet Richard Armour put it:



> So leap with joy, be blithe and gay
> Or weep, my friends, with sorrow.
> What California is today,
> The rest will be tomorrow.

This survey will consider how far California remains a trailblazer. There are plenty of clues. Exercised by the importance of intellectual capital? Come to the home of nanotech and Nemo, of biotech and Buffy, and producer of more software than anywhere else. Worried about the growth of gated communities? Then look at Irvine, Valencia or any of California's private cities. Interested in demographic change? In 1970, four in five Californians were white; now whites are a minority.

Yet some of these changes make the state even harder to define. California has always packed as much diverse geography into one state as Europe does into a whole continent, stretching from the Saharan dunes of the Mojave desert to the snow-capped peaks of Mount Shasta. The rain-sodden greenery of the northern part looks downright British; when Francis Drake landed there, he called the state Nova Albion because it reminded him of home. Politically, the north and the south have feuded since the state's inception; so have the cosmopolitan coastal cities and the more conservative heartland.

Joan Didion, the state's muse, who now lives in New York, distinguishes between five different Californias; the rainy part north of San Francisco; the Bay Area, including San Francisco, which she elongates down to a point somewhere above Santa Barbara; the southern sprawl, which stretches down to the border and encompasses Los Angeles and San Diego; the huge and until recently mainly rural Central Valley; and Sacramento, her home town and California's beleaguered capital, which she thinks of as a state by itself.

Others would argue that hyper-liberal San Francisco or the hyper-conservative bits of Orange County are extraordinary enough to be plucked out from their various sprawls. And what have the People's Republic of Berkeley, the Vietnamese outpost of Westminster or the Napa Valley wine country in common with their neighbours? Downtown Los Angeles and West Los Angeles may both contain plenty of rich knowledge workers, but they might as well be in different time-zones: whereas the financiers downtown start their day at 6am, the entertainment crowd in West Hollywood, Beverly Hills and Santa Monica slope in closer to 10am.

The blonde and the gym?

The biggest differences in California are not geographical but social. For all its claims to first-names-please meritocracy, California is one of the most unequal states in the world's least equal developed

country. Until recently, much of its land was owned by a small coterie of feudal landowners. The night before the Oscar awards, *le tout* Hollywood descended on Coldwater Canyon for a party. The mogul in question had re-landscaped the top of his hill to make valet-parking easier, and the valets were jogging up and down the hill. The guests would not have dreamt of parking their own cars and walking. It would have been like Marie Antoinette getting out of her carriage. But there is also eye-catching poverty: in the scorching Coachella Valley in the eastern desert, you come across trailer-park encampments reminiscent of John Steinbeck's novel, “The Grapes of Wrath”.

Calling in an action hero seems appropriate for California, because the state epitomises another Hollywood stereotype: the beautiful broad who never had to try—until now. Most other countries and states would kill to have California's problems: to be burdened by quite so many precarious high-tech industries, to have such a young population to educate, to have so much splendid landscape to protect. Yet California has done precious little to stay in shape—and there are just the first glimmers of competition from places that were born less beautiful, but try harder.

California has done precious little to stay in shape

California's refusal to deal with its problems is typified by the submerged debate about race. Many whites worry that the state is becoming Mexifornia (there is already a border town called Calexico); that the great Californian melting pot cannot absorb the number of immigrants now washing in. In reality, there is every chance that in 50 years' time there will be fewer Californians speaking Spanish than there are now—provided the state schools can teach them decent English. But that, alas, raises a big question.

The truth is that California's schools are not good enough. Many Latinos drop out before collecting a high-school diploma. The state does not have a race problem, but it certainly has an education problem—just as it has an energy problem, a transport problem, and an overwhelming anything-to-do-with-government problem.

The underlying structure of Californian government is rotten—unaccountable, capricious, counterproductive and often deeply undemocratic. Some of this has to do with the speed with which the state has grown. Nobody has drawn up a proper master-plan for California's government since 1879, when the state had 865,000 inhabitants; now a single district in the state Senate contains that many people, but the Senate still has only 40 seats.

But there are also more recent causes for the travails of California's government. Chief among them is the passing in 1978 of Proposition 13, a tax-cutting initiative that had a worthy aim—to stop property taxes getting out of hand. But it upset government finances, forcing local authorities to rely on the state and blurring lines of accountability. It also set off a train of other initiatives that limited politicians' scope for action: three-quarters of the state's budget is now outside their control.

Many argue that redistricting in the state legislature, which ensured that virtually all the incumbents have safe seats, has done more damage than Proposition 13. But whatever the reason for the mess, it is clear that the boldness, inventiveness and efficiency that are the hallmarks of California's private sector have been largely absent from its public counterpart—and it is beginning to show. The state has gradually slid down the income-per-head ratings; in 2002 it was overtaken as America's biggest exporter by Texas; every year, more rich white Californians in effect secede from the state, setting up home in planned communities with their own rules, schools, security guards and often walls.

In terms of party politics, the state has been in gridlock for some time. The Democrats, heavily reliant on the public-sector trade unions, will not consider reform. The Republicans, for their part, have clung on to the myth that disdain for government is a strength—the flip side of the rugged individualism that has powered the economy. Yet the state's businesses get much of their living from government contracts, and government has helped pay for all manner of things, from freeways to universities. Listening to a conservative Californian inveighing against Washington brings to mind the Jewish patriot in the Monty Python film “Life of Brian”. “All right,” he concedes. “But what, apart from the sanitation, the medicine, education, wine, public order, irrigation, roads, the fresh-water system and public health...what have the Romans ever done for us?”

By failing to pay attention to government, California has not ended up with minimal government—just bad, needlessly big government

By failing to pay attention to government, California has not ended up with minimal government—just bad, needlessly big government. A century ago, California vied for European immigrants with another paradise full of disdainers of government: Argentina, which had leapt to become the world's sixth-largest

economy. In 2001, that country, its natural advantages ruined by generations of ghastly government, went bust.

Kevin Starr, California's foremost historian, speculates that the state's refusal to confront its problems is linked to its entertainment culture: “There is a high level of fantasy and unreality in California and this is applicable to its political situation.” Ironically, an actor represents the state's best chance for getting out of its predicament. This survey will explain why he should press ahead boldly.

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The wrong sort of government

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Why California can't get it together

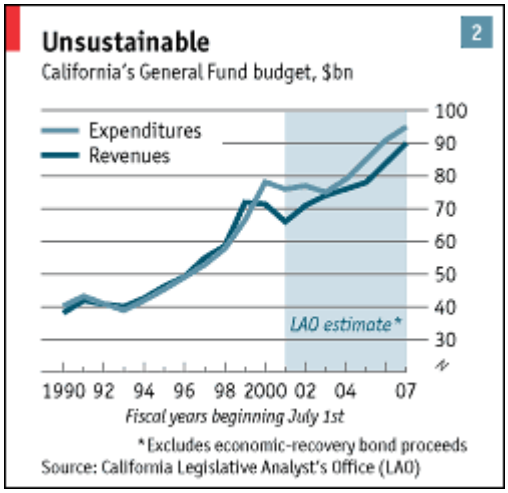
Corbis

Gee, Ethel, we just destroyed representative government

CAN the “crisis of government” in one of the world's most successful economies really be that bad? No and yes. The budget crisis, which has dominated politics for the past two years and triggered the removal of Gray Davis, is less severe than often supposed. But the underlying paralysis of government is much worse.

The budget problem is straightforward enough. It was caused by the state spending like a drunken sailor during the “new economy” of the late 1990s. Thanks largely to soaring capital-gains tax receipts, revenues in the general fund, the core part of the state's budget, rose by $20 billion in 1998-2000, to over $70 billion; but spending rose even faster as Mr Davis increased the allocation for virtually every department of state government (see chart 2).

This money was not entirely wasted: it helped reduce class sizes in schools, for instance, and it expanded the measly health-care services available to the poor. All the same, set alongside Pat Brown's spending spree in the 1960s, it is hard to point to many concrete achievements. The main trouble was that the Democrats acted as if the capital-gains receipts were part of the state's regular, sustainable income. When the dotcom bubble burst in 2001, Mr Davis reined in spending a little and raised some taxes and fees. But closing the gap also required fiddling the books, postponing payments to local government and short-term borrowing of some $14 billion.



Arnold Schwarzenegger made things worse by repealing an unpopular vehicle-licence-fee hike (which would have brought in $4 billion). But he tidied up the accumulated historic deficit by pushing through Proposition 57, allowing $15 billion-worth of longer-term bonds to be issued to cover the debt. The state treasurer, Phil Angelides, the only leading Democrat not to rally to Proposition 57 (and, coincidentally, a possible gubernatorial rival), complains that the bond issue “mortgaged our future”. But Mr Schwarzenegger made it more palatable for voters by packaging the bond initiative with Proposition 58. This forces the state legislature to balance the budget, on pain of various sanctions.

However, all this still leaves Mr Schwarzenegger with a continuing structural deficit of close to $1 billion a month in the next fiscal year, beginning in July. He might be able to extract a little money from his Republican allies in Congress; Californians complain that only three-quarters of the money they send to the capital in tax comes back as spending, a below-average proportion. But in the end the deficit will have to be closed mostly by tax rises or spending cuts. From the governor's point of view, spending cuts look the lesser of two evils. True, they will make the Democrats feel less chummy towards him; but tax rises would devastate his fragile relations with the state Republicans.

Besides, after the spending splurge of the late 1990s, there is surely fat to cut. John Cogan, one of the governor's financial advisers, points out that even if all of the forecast deficit were to be closed by spending cuts, it would still leave state spending per head above its level in 1999. Recent audits have discovered plenty of questionable expenditure, such as the $125,000 that the Department of Motor Vehicles handed out to encourage people to take part in the census, and the $722,000 to monitor and house one released child-molester.

Despite all the talk about the “record-setting deficit”, it is proportionately less painful than the crunch faced by Pete Wilson in 1991; then the new governor had to plug a $14 billion hole at a time when spending was barely half the present size. But even if the crises have arguably got less severe, the government that causes them has become more dysfunctional.

To an outsider, the first indication of the extent of the mess is the administrative map, designed largely for a 19th-century agricultural state. It shows 58 counties, which vary in size from Los Angeles (with a population of 10m) to Alpine (population 1,200). These are joined by nearly 500 cities, ranging from Los Angeles (3.7m) to Vernon in LA County (91). Then there are 4,700 special districts, covering things like sewerage and water, but not including 983 school districts, again varying from tiny areas with just one school to Los Angeles Unified, which has its own TV station and teaches 700,000 pupils—a figure close to San Francisco's entire population.

This makes local government remarkably difficult to understand. Some cities in Los Angeles County have police forces, others do not. San Francisco is a city, a county and a school district; it also includes a huge hospital. And with some 15,000 elected local officers in the state, there is plenty of overlap. Alongside Mr Schwarzenegger's appointed (mainly Republican) cabinet of advisers on transport, finance, education and so on, there is another cabinet's-worth of directly elected (and thus currently Democrat) officials, such as the state treasurer, insurance commissioner and so on.

Still harder to fathom is who pays for what. Here Proposition 13 was crucial. In essence, the ballot initiative passed in June 1978 halved property taxes, the main revenue source of local government; it also capped property taxes at 1% of the property's value at purchase, with a 2% annual limit on any increases thereafter. That limit explains why you can move into a house in California and discover that you are paying several times as much in property tax as your long-established neighbour.

It also dramatically shifted the burden from local government to state government. When their property taxes were cut, the local authorities appealed to the state, which at the time had a $5 billion surplus. It bailed them out, starting an ever more complicated series of rebates and borrowing between the different levels of government. Most of the money in the state is now collected locally, then sent up to Sacramento, then parcelled down again.

The system puzzles even the experts

The system puzzles even the experts. When Mr Cogan looked through the books at Mr Schwarzenegger's request, he was surprised to see no mention of the new vehicle-licence tax in the state's revenues. Eventually he found it, recorded as a decrease in spending: the car-tax money stayed with local government, so the state sent less money down the system. Mr Schwarzenegger himself has already done a little juggling: the bonds in Proposition 57 are being repaid from a chunk of the sales tax, which cities would normally keep.

Blame someone else

It is not just a matter of book-keeping, but accountability. Even reformers accept that the state government must play a role in balancing out the funding difference between, say, the schools in rich Palo Alto and poor East Palo Alto; but Proposition 13 has removed any connection between local spending and control. If you blame the local school board for your terrible schools, it will say that the cuts from Sacramento are to blame. When school districts could raise property taxes, local business people took an

interest in them; now they are, in effect, run by the teachers' unions.

One of the fastest-growing bits of the state budget has been health care, much of it mandated by the federal government. This is partly because the system is administered by the counties, but they have no incentive to save money when the proceeds will go to Sacramento.

However, the most important change brought about by Proposition 13 was not its direct effect on spending but its indirect effect on democracy, wrote Peter Schrag, a veteran local commentator, in an essay in *California Journal* last year. Ballot initiatives had been introduced (alongside the recall) by Progressive reformers at the beginning of the 20th century as a way of balancing the power of vested interests in the legislature. They were meant to be used sparingly: in the 1960s, only nine went to a vote.

Proposition 13 prompted an explosion of activity. Since it was passed, some 800 statewide initiatives have been launched and their scope has increased dramatically, with voters laying down rules for state politicians on everything from criminal sentences and affirmative action to how much of the budget must go to schools. There has also been a flurry of local initiatives.

Some of these new laws have been sensible, but the swirl of initiatives has made the democratic process even less intelligible to voters. It is also tiring them out. In November 2000, for instance, an Angeleno voter found himself faced with 40 separate decisions to make on the ballot. Far from fighting special interests, initiatives have become their tools. Launching an initiative can easily cost $15m to gather signatures and run advertisements.

Ballot initiatives have gradually eaten away at representative government

Worst of all, the ballot initiatives have gradually eaten away at representative government. Between two-thirds and three-quarters of the budget is now out of the legislature's and the governor's control. And term limits restricting a politician to six years in the state Assembly and eight in the state Senate mean that many state politicians are short of experience, making them easy prey for Sacramento's permanent population of lobbyists.

This might make you feel sorry for the legislature. Don't be. Many of the biggest problems in California stem from that body. True, some of them have been handed down to it by the state's constitution. A two-thirds majority, rather than a simple majority, is needed to pass a budget, which helps to explain why there is a budget crisis virtually every year. The legislature is also handicapped by being so small: there are only 80 seats in the Assembly and 40 in the state Senate, so state senators have considerably bigger districts than Californian congressmen.

Yet many of the legislature's problems are self-inflicted. Redistricting, rather than being administered by nominally independent bureaucrats, has been carried out in an absurdly partisan way, with the ruling Democrats gathering up their own supporters in the greatest number of safe liberal seats, and isolating Republicans in heavily conservative seats. There are no more than five of the 120 seats in the legislature and perhaps only three of the 53 seats in Congress where the outcome of an election seems uncertain.

This further alienates the electorate from the political process: what is the point of voting if the result is a foregone conclusion? Turnout for elections in California is amongst the lowest in the whole of the United States. Redistricting has also guaranteed a legislature of extremists on both sides. For most incumbents, the really important battle is the primary—which means keeping the activists happy. No Republican can afford to authorise a tax rise or offend the Christian right. Likewise, no Democrat in the state is likely to come out against abortion.

Many other states share some of the elements of California's condition, but none of them suffers such total paralysis of government. Californians have ended up with the worst of all worlds: a government that costs more to run than those in other states yet delivers less in the way of results; and a democracy with thousands of politicians but no one, it seems, who is accountable for anything.

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Stuff of dreams

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The charm of the never-ending suburb

THE Californian dream comes in many shapes and sizes—from Cameron Diaz to Chez Panisse, from the Apple iPod to a bottle of Robert Mondavi Opus One, from the sunset at Big Sur to the hybrid hum of a Toyota Prius. But the dream that matters for most people—the one that propels the state forward—is to be found in its latest manifestation at Victorville.

Victorville is a dusty, inhospitable town in the High Desert, where temperatures stay above 105°F (41°C) in the summer. To reach the new edge of the southern Californian sprawl, you drive east from Los Angeles for 100 miles and then up over the 4,000-foot Cajon pass, towards Las Vegas (see map). Victorville's best-known feature is the former George airbase, which now provides dry parking space for unwanted airliners. These days the town fancies itself as a logistics centre: it has already attracted a distribution depot for Wal-Mart. It also boasts a couple of prisons.

In fact, its real business revolves around the two things at the heart of the Californian dream: a suburban home and a car. Asked where they want to live, nine out of ten Californians say in a single-family detached home; two-thirds want to live in a low-density neighbourhood where driving is a necessity. In 2002, 75% of Californians drove to work without passengers.

Californian suburban life has been satirised to death by Hollywood, and it has long been deplored by environmentalists. But the plain fact is that a huge number of people seem to like it. Everywhere you look in Victorville, homes are being sold, built or prospected. The High Desert, which includes Hesperia

and Apple Valley, used to be home to 100,000 people; now it has 300,000. Victorville has electricity (from a new power station), water (from a vast, allegedly underused aquifer), acres of space, and what might be called a pro-growth attitude. House prices have trebled in the past three years, but you can still buy a family home for less than $200,000, half the price of one in Orange County; so people keep on coming.

Victorville represents the north-eastern edge of a phenomenon known as the Inland Empire, technically the suburban sprawl gathered up in Riverside and San Bernardino counties. Inland imperialists now number 3.6m, of whom 660,000 arrived during the 1990s (550,000 of them Latinos). By 2020, there are expected to be 4.8m. The main reason for this growth is not hard to spot. In Orange County, only 18% of all families can afford to buy a median-priced home; in the Inland Empire, half the families can stretch to it.

But the Inland Empire is not just a huge dormitory. An area whose economy used to be grounded in agriculture, military bases and the railroad now boasts biotech firms and stockbrokers. A list of good places to do business drawn up by *Inc* magazine features more cities there than in Los Angeles County or the Bay Area.

To the visitor, the Inland Empire seems as disorganised as it is ugly. But John Husing, a local economist, points out that it is progressing in the same way as other suburbs-cum-exurbs-cum-edge-cities, such as the San Gabriel Valley and the Simi Valley. The Californian sprawl advances in three steps.

•In the first phase, typified by Victorville, blue-collar families and developers discover a new cheap place to live. They are soon followed by what Mr Husing calls population-serving jobs: estate agents, shops, local government. In the Victor Valley, there are only 0.65 jobs for each dwelling—roughly half the level on the coast.

•In the second phase, these commuters are joined by “big space” firms—industrial units, or the distributors that Victorville hopes to attract. For instance, until 2000, most industrialists ignored the East San Bernardino Valley, staying west of the I5 freeway; but since then 25 facilities of more than 250,000 square feet have appeared. Now there are roughly as many jobs as dwellings in the East San Bernardino Valley, according to Mr Husing.

•In the final phase, better-paid white-collar workers and professionals move into the area; so do the companies where they want to work. Go to the west end of San Bernardino or Riverside, and you discover the same sort of glass-fronted offices, gated communities and ever more expensive homes that you find in Orange County. With even rented accommodation becoming fairly pricey, the poorer blue-collar workers start looking for somewhere else to live—such as Victorville.

And so it goes on

This relentless horizontal sprawl is epitomised by southern California, but the same three-step development is also on view in the Bay Area, where the suburbs are rippling inland, and now even in the Central Valley, which some people expect to be where the sprawl comes to a stop.

The Central Valley is increasingly producing houses, factories and offices instead of alfalfa. At a country club just outside Fresno, with several thousand homes being built around the surrounding golf course, a software entrepreneur who fled LA and a local farmer who has diversified into luggage manufacturing reckon they may be sitting in the new Orange County.

Steve Pon Tell, one of the authors of a recent report on the Inland Empire, thinks one attraction of the Californian sprawl is that it is multimodal. Anybody can go anywhere: people in the Inland Empire can commute to Los Angeles, to Orange County, to Pasadena, to Ventura. Rather than being fed by the public transport system into one central hub, people get into their cars and make their own way across the freeway grid.

For decades, greens have claimed that the Californian sprawl would have to stop somewhere, and indeed it imposes plenty of obvious environmental costs. There are persistent worries about water—though people consume less of the stuff than alfalfa plants do. In Fresno, the extra people are making the air quality worse. And those who care about such things fret that the Mojave ground squirrel is being pushed out of Victorville.

Yet many Californians are not worried about their state building too many houses and freeways; rather, they think it is not building enough of them. Multimodal transport works only if there are enough roads. As he crawls across Victorville in his Jeep, one young estate agent who grew up there recalls wistfully how it used to take him less than five minutes to get across the town. The drive is much longer for the new arrivals in Victorville, who mostly work over the Cajon Pass.

The lack of new houses is an even bigger brake. On average, you need one new house for every 1.5 new jobs. Over the past decade, 10m people have arrived in the state, but it has built only 1m new houses. This has pushed up house prices. It has also forced many people, and Latinos in particular, to share accommodation, increasing population density.

This crisis has more to do with politics than with space and natural resources. Some richer white areas have voted to limit growth in their neighbourhood: between 1986 and 2000, 671 local initiatives about growth were launched, and three-fifths of them were won by the anti-growth lobby. A bigger problem, inevitably, is Proposition 13, which has biased many cities against building new houses.

Christine Tien, the deputy city manager in Stockton, points to a huge new mall being built along the local freeway. Its main attraction for the city is that its businesses will generate sales taxes, which the city can keep. Had the area been zoned for houses, the amount of property tax coming in would have been far lower, and most of it would have gone to Sacramento. According to one informal calculation, a local authority makes a profit from residential development only on houses worth more than $600,000.

None of this causes the dream to lose its allure. John and Lucy, a recently married pair of Asian-Americans from San Gabriel, sitting outside a bank advertising home loans in Victorville, know all the drawbacks: yes, the commute will be longer than they want; yes, they wish there were more houses in their price range. But they do not want to live with her parents, and they are sure that things will work out. “California is the best place to make money in the world,” says John. But is it?

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A bad place to do business?

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Too much regulation, too little infrastructure

Newsmaker

How to go out of business

IF CALIFORNIA wanted to promote itself as a beacon for entrepreneurs, then Carmen Saenz-Murray would appear to be its ideal poster girl. Four decades ago, her mother sneaked across the border from her dirt-floor house in Juarez to El Paso so her illegitimate daughter could be born in America. At six, Carmen was selling burritos in the streets. When she was ten, the family moved to join her father in the City of Commerce, just east of Los Angeles. She struggled with her English, but was rescued by a kindly teacher, Mrs Epsen. Too poor for college (or so she thought), she got a job at McDonald's and pushed her way from the counter into lower management.

Having married an “Anglo”, somewhat to her surprise, she got a part-time job as a receptionist at Rodeo Carpet Mills in Commerce. She now owns and runs the company, which makes upmarket carpets for mansions, private jets and home cinemas. Her daughter may go to Harvard.

Rodeo employs 30 people. It is just coming out of a dire downturn, when Ms Murray had to lay off ten people, persuade the rest to pay a quarter of their own health insurance and draw no salary herself. Now the company is back in profit. Yet Ms Murray is not content: “My lease comes up in 2007, and if things have not changed, this company will move out of the state.”

Everywhere you go in California, you hear the sound of businesspeople gnashing their teeth. California has always lost jobs to other places (one of the strong points of its economy is its capacity for creative destruction), so bleating businesspeople are nothing new. All the same, a survey for the California Business Roundtable by Bain, a management consultancy, makes damning reading: two of five bosses the consultants talked to now have an explicit policy to move jobs outside the state, with Texas being the most common destination.

This pessimism is all the more remarkable when you look at the way California—the centre of the bubble economy—has powered through the recent downturn. This year the gross state product should grow by around 4%, broadly in line with the nation's recovery. As elsewhere in America, recovery in California has been relatively jobless. Yet for most Californians the current downturn has been fairly mild, especially when set against the recession of the early 1990s. According to Stephen Levy of the Centre for Continuing Study of the California Economy, eight of the state's nine economic regions have lost fewer jobs than the nation as a whole; only Silicon Valley has done much worse (see article). Similarly, out of California's enviable range of industries, only two have been hit hard: high-tech and tourism.

And the reality may be even better than the official numbers. Jack Kyser of the Los Angeles Economic Development Corporation points out that LA County technically lost jobs in 2002 and 2003. But it is hard to measure an economy that has so few big firms (for example, there are no *Fortune* 500 companies based in downtown Los Angeles). And even global businesses can be hard to tie down. Until recently, Mr Kyser had thought that LA's jewellery industry sold no more than $200m-worth of trinkets; then one jeweller let drop that sales were twice that level.

Jewellery and carpets are good examples of the diversity of California's commercial base. Most people associate LA with movies and aerospace. Los Angeles is home to a myriad smaller clusters making more down-to-earth things, such as furniture, toys and pornography. Meanwhile, a long list of global

manufacturing businesses, including the Japanese car giants, keep their creative arms in the southern Californian sprawl to gain the network effects from having so many designers and trendsetters around the place.

California's competitive advantage is rooted not just in having the right business base, but in having the right people. From San Diego to Eureka, the state is stuffed full of entrepreneurs like Ms Murray who are convinced that they will eventually make a pot of gold. One of the things in its favour is relative youth. By 2050, thanks to all those immigrants, the average Californian will be three or four years younger than the average American.

Network effects, clusters, optimism: these are the sort of intangibles that count for so much in modern economies—and which other people desperately want to emulate. Given California's natural advantages, its regulatory climate does not need to be particularly good; it merely needs not to be dreadful. Alas, it flunks that test.

It hurts here

California's government is gradually destroying its competitive advantage in two ways: by snarling up its businesses in unnecessary red tape; and by under-investing in the infrastructure any economy needs. The first can partly be blamed on the state having too many left-of-centre politicians; the second, paradoxically, on it having too many conservative voters. But both also have deep structural roots.

Top of the list of regulatory bugbears is workers' compensation, the much-abused system for claiming money for injuries, which has become a junket for lawyers and dodgy doctors. In the past three years, Rodeo Carpet Mills' “workers' comp” costs have risen from $1,200 to $4,900 a month, even though it employs fewer people. Ms Murray has just spent a couple of years successfully fighting off a claim for $30,000 from a woman who decided that she had suffered stress after being laid off.

Last month, Arnold Schwarzenegger pushed a workers'-comp bill though the legislature, telling Democrats (who receive a lot of campaign contributions from lawyers) that he would back a pro-business ballot initiative if they did not shift ground. In theory, the reforms should halve the costs by 2006 (when the statewide total was expected to reach $30 billion). But there have been other fixes before—in 1982, 1989, 1993 and 2003—and the lawyers have found ways around them.

Another battle is brewing over health care. Mr Davis's last act as governor was to sign Senate Bill Two, which has the commendable aim of trying to extend health insurance to the 6m Californians who do not currently have it. But, rather like Hillary Clinton's ill-fated health-care plan, SB2 forces businesses—initially companies with at least 200 employees, but eventually ones with 20—to provide the cover. Already there are reports of companies arranging themselves so that they will never have more than 19 employees.

The biggest problem for small businesses is the thicket of minor legislation. For instance, in the rest of America, overtime is calculated on a weekly basis; in California, it is done by the day. According to Bain, between 1992 and 2000 California made 15 changes a year in its labour laws, four times the national rate. Jerry Brown, a former governor who is now the mayor of Oakland, says that since he left office in 1982, 27,000 laws have been passed.

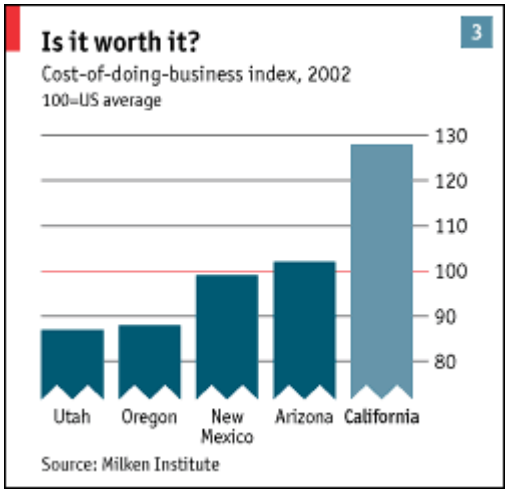
And these, remember, are just the state rules. In California, there are umpteen other layers of overlapping government. Up in the wine country, a vineyard owner moans that he has to turn away people who want to have their wedding at his vineyard, because local rules in Napa and Sonoma limit the number of people who can visit a vineyard.

There are umpteen layers of overlapping government

Even if Mr Schwarzenegger succeeded in making every bureaucrat in the state work with Terminator-like efficiency, many of them would still be working at cross-purposes. Other states offer business one-stop shops, but California presents an obstacle course. Rodeo Carpet Mills, for example, has to deal with the state, with the City of Commerce, with Los Angeles County, with the South Coast Air Quality Management District people and many more besides. One of the five administrative jobs at the company is, in effect, devoted to dealing with bits of government.

Bain calculates that a small manufacturer with $20m in revenues and $200,000 in operating profits would gain $1m if it moved to

South Carolina, Georgia or Nevada. According to the Milken Institute, the cost of doing business in California is now way above that in any of its neighbours (see chart 3).



Ms Murray is less concerned about the cost of all this bureaucracy than about its unpredictability. Presented with a business challenge—such as competition from Thailand, which can make carpets for around 40% less than Rodeo—she can plan ahead. The sudden imposition of new charges is harder to deal with. Bain compares the time it takes to get preliminary approval of maps for residential subdivisions; California is not only slow (5% get approved in ten weeks compared with 60% in Arizona and 80% in Texas) but less predictable: it can take nearly two years.

To add to their woes, Californian business leaders are now having to face up to a problem for which they share some of the blame: infrastructure. A business has to have access to electricity, water, transport and decent staff. Yet the entrepreneurial classes have been extremely reluctant to let the state spend money on any of these items. Most of the state's physical infrastructure dates back to the 1960s and Governor Pat Brown's building splurge.

The current Schwarzenegger budget remains tight-fisted. Rather than raise taxes, it cuts money for universities (where California ranks 28th among the states in terms of spending per head) and transport (45th). “When California says it has not got enough money to send kids to public universities and cannot build freeways, that is very good news for Texas,” says Mr Levy.

The state's problems are not simply a matter of low investment. They are just as much due to a strangely un-Californian refusal to experiment, to introduce market forces by allowing proper pricing and competition, or even to learn from mistakes. Take the two fuels on which California runs: water and energy.

Under-endowed

California has done little to build new aqueducts or reservoirs, and it is even more vulnerable to the weather now that the other fast-growing states in the west are claiming more of their share of the Colorado river. A drought might revive a much-needed debate about the role of agriculture. The industry accounts for 2% of the state's economy but uses 80% of its water, which it gets at subsidised rates and uses to grow, among other things, thirsty crops such as rice, alfalfa and cotton.

As for energy, when Californians suffered repeated blackouts three years ago, Mr Davis blamed out-of-state companies for defrauding consumers. There was a grain of truth in that, but the main causes were, first, the state's adamant refusal to let anybody build power plants and, second, a botched attempt at “deregulation”: ingeniously, California had devised a system that held consumer prices stable but allowed wholesale prices to fluctuate.

Mr Davis eventually managed to “solve” the crisis by partially nationalising the industry and signing expensive long-term contracts with the power companies, but neither of the underlying causes of the energy crisis have been tackled. Mr Schwarzenegger wants to renegotiate the contracts; if he does not get his way, another such crisis is likely to blow up in the next few years (and it takes at least two years to build a power station).

The longer you look at the energy crisis, the more amazing it seems. It brought the state to a halt, enraged consumers and arguably cost Mr Davis his job (his reputation never really recovered). Yet nothing much has been done to stop the same thing happening all over again. It makes you wonder how the state will cope with the far greater challenges posed to its human infrastructure by the arrival of 10m people over the past decade, most of them poor and uneducated, and the transformation of its demographic make-up.

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Exit strategy

Apr 29th 2004
From The Economist print edition

Can Silicon Valley's magic last?

SALESFORCE.COM is the sort of outfit that for many technology people epitomises the Bay Area. The company, which offers clients a cheap way to manage their marketing teams through the web, was founded only five years ago by Marc Benioff, a well-connected manager for Oracle, in his flat. It now employs 450 people scattered around the world, including 250 in its cooler-than-thou headquarters on Market Street. A public offering is in prospect.

“There are other places where this is possible,” Mr Benioff concedes, “but no other place where it has consistently happened.” Clever engineers, financiers and marketers can be found elsewhere, but there are not so many to choose from.

The Bay Area is still home to the world's greatest technology cluster, but it has just been through the wringer. Santa Clara County, the heart of Silicon Valley, has lost nearly a fifth of its jobs in three years—the biggest direct hit to a cluster since the Great Depression, according to Ross DeVol at the Milken Institute. Places such as Akron (tyres) and Cleveland (steel) in Ohio suffered similar contractions, but over longer periods.

And now comes a new spectre: outsourcing. Put together the Bay Area's outrageously high costs and its appalling infrastructure with the ever-increasing number of perfectly competent programmers elsewhere (not just Austin and Raleigh, but Bangalore and Prague) and, surely, the valley will gradually be hollowed out?

This argument contains two huge exaggerations and one kernel of truth. The first exaggeration has to do with numbers: nobody has yet come up with a reliable figure for jobs lost through outsourcing, but they are a small fraction of the number lost because of the bubble. The second is the notion that this is something entirely new. The story of the valley has been one of relentless creative destruction. Unlike Akron and Cleveland, the valley is still at the front of its industry, colonising new fields such as nanotechnology. Through its network of venture capitalists, it is also the money centre.

The kernel of truth is that other clusters are getting a little closer. John Hagel, a local consultant, points out that some start-ups are now beginning life as “half-and-halfs”, with their headquarters in the valley but most of their engineering in India. This is not just to do with cost; the would-be Silicons elsewhere are also acquiring a whiff of the same sort of atmosphere—the links between universities and geeks, the transfer of ideas, the bars. These things may sound ethereal, but they are the heart of the valley.

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Just like the rest of us

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Like other immigrants before them, Latinos can be assimilated

Getty Images

Americans—and here to stay

> "HE'D been in Los Angeles nearly two years now, and he'd never really thought about them before, but they were everywhere, these men, ubiquitous, silently going about their business, whether it be mopping up the floors at McDonald's, inverting trash cans in the alley out back of Emilio's or moving purposefully behind the rakes and blowers that combed the pristine lawns of Arroyo Blanco Estates twice a week. Where had they all come from? What did they want? And why did they have to throw themselves under the wheels of his car?"

T.C. Boyle's "Tortilla Curtain" (1995) is contemporary Los Angeles's best attempt at an epochal novel. On his way back home to his soon-to-be-gated community, Delaney, a sensitive white environmentalist, knocks down an elderly illegal immigrant, Candido. The day-labourer takes $20 and limps back to his squatters' camp and his 17-year-old pregnant wife. Neither of the men ever recovers from the incident.

Tolerance, insists Kevin Starr, the historian, has always been the state's competitive advantage. But others are beginning to worry that it has been too tolerant. The state is changing shape in two generations. In 1990, it was 57% white and 25% Latino; by 2040 it is expected to be 48% Latino and 31% white. When Mexico plays the United States at soccer in California, it gets most of the support.

Victor Davis Hanson, a professor at California State University, Fresno, last year argued for stricter immigration controls in his book, "Mexifornia: A State of Becoming". From Harvard, Samuel Huntington (of "Clash of Civilisations" fame) recently wrote in *Foreign Policy* that Hispanic immigration "poses a fundamental question: will the United States remain a country with a single national language and a core Anglo-Protestant culture?"

Mr Huntington's warning concerns America as a whole, but a third of the Latinos in the country live in California. In 2003, for the first time since the 1850s, most babies in California were Latino. The state's foreign-born population also has more people from Mexico than from the whole of Europe and Asia. In Los Angeles, there are now roughly as many Mexican-Americans as whites, and by the end of the decade Latinos will be in the majority.

It is not just a matter of numbers, argue the worriers; Latinos are harder to assimilate because their homeland is so close. They have not kissed goodbye to their past, as John Steinbeck's wretched Okies did 65 years ago. Latinos are always nipping back over the border. Moreover, their arrival has coincided with a new fashion for multiculturalism: rather than being forced to become American, Latinos are now being told by left-wing professors to hang on to their culture and celebrate their diversity.

Don't mention it

There has been something of a conspiracy of silence on the subject of immigration among the state's leaders. Businesspeople do not want to talk about the cheap labour that picks their apricots, cleans their cars and looks after their children. Unionists also bite their tongues, now that they no longer see immigrants as job-stealers but as potential recruits. And politicians from both parties are now chasing their votes.

That does not mean that immigration is not an issue. Proposition 187, which aimed to withdraw benefits

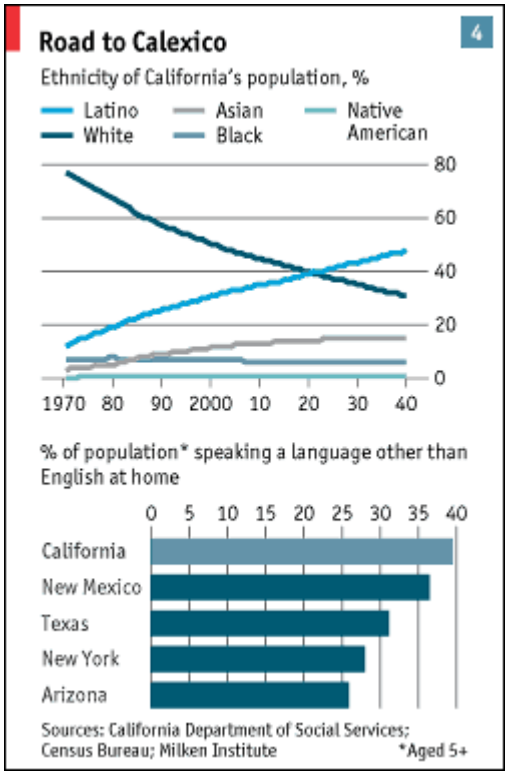
from illegal immigrants, was passed overwhelmingly in 1994, with one in four Latinos supporting it, even if it was later struck down by the courts. Certainly, Mr Schwarzenegger's confession during the recall election that he backed 187 did him no harm at all.

But does the rise of the Latinos really amount to something new? Joel Kotkin of Pepperdine University argues that a lot depends on how you define the status quo. After all, as immigrants get absorbed in the melting pot, they also change the content of the pot, and nowhere more so than in California, which is already a far more diverse place than, say, Massachusetts.

Consider, for instance, the emergence of Jennifer Lopez and other Latino pop stars. An elderly Anglo-Saxon professor might see this as part of America's Hispanification. Looked at through the eyes of a Latina matron, however, the provocative chanteuse-cum-actress might seem far too Anglo for her own good. As for young Californians, one admittedly unscientific poll of four teenagers outside a music shop in the San Fernando Valley merely turned up the information that Ms Lopez was “hot” and that she probably shouldn't have dumped Ben Affleck. In a state where nearly every teenager is half-something, ethnicity is a passing detail, especially when set against a nice bottom.

Even when you turn to slightly more reliable statistics, most of the available evidence seems to suggest that Latinos will follow broadly the same path as, say, Italian-Americans into middle-class American life. Ever more of them are buying homes, and ever more setting up businesses. The Inland Empire is stuffed full of impeccably bourgeois middle-class Latino families. The Latino-owned Jaguar dealership in Riverside now sells around half its cars to Latinos.

Rather than trying to fight against Americanisation, Latinos seem to be welcoming it. Gregory Rodriguez at the New America Foundation points out that Latinos have made absolutely no attempt at political separation; nor have they tried to set up Spanish-language schools to teach their children their mother tongue, as, say, Chinese immigrants have done.



Indeed, those Spanish voices may be silenced surprisingly soon. As things stand, nearly three-quarters of first-generation immigrants speak a language other than English at home; by the third generation, two-thirds speak only English. America, Mr Rodriguez points out, is a language graveyard.

Bet on English

Besides, what kind of Spanish would a Mexifornia speak? One of the secrets of multiculturalism is that many Latinos speak Spanish rather badly. Many of the new immigrants come from poor rural areas not famed for their elocution; but middle-class second- and third-generation Latinos are not that much better. Several prominent Latino politicians speak pretty dismal Spanish.

Arguments about race remain immensely complicated. For every bad sign (battles have broken out between blacks and Latinos in prison) you can usually find a good one (in Stockton, gangs are defined by geography rather than by the colour of their skin). Yet it is hard to believe that Latinos will not become ever more American, simply because it is so much easier and more profitable for them to do so. Their integration may take a little longer, but they are not indigestible.

However, three caveats remain, all in some way connected to California's dysfunctional government. The first has to do with racial identification. Despite the glorious miscegenation happening all around it, the state government in general, and Democrat politicians in particular, seem keen to hang on to old racial categories.

From this perspective, California's voters took two big steps forward in the 1990s. The first was getting rid of bilingual education in 1998 through Proposition 227. Even if some children gained from being taught in Spanish, the programme existed largely as a boondoggle for the teachers. Test scores have improved a little since. The other victory, also achieved in the teeth of opposition from the “educrats”, was getting rid of affirmative action for minorities at the state's universities through Proposition 209 in

1996. This was widely forecast to prove disastrous to minority admissions, but the net effect has been small.

Last year, the black businessman who championed that effort, Ward Connerly, sponsored an initiative to ban racial identification (except for medical research). It failed, partly because Mr Schwarzenegger, somewhat spinelessly, opposed it. Mr Connerly will try again with a different wording. “Adherence to racial identity in a state like California can only hurt us,” he says. One of his own grandparents was white, another was part Choctaw Indian, and he has married a white woman.

The second caveat has to do with politics. Latinos vote in low numbers and have few political leaders. In Stockton, for instance, they account for a third of the population but there are no Latinos on the council (though there is a black and an Asian). Latino politicians have recently lost prominent races to be mayor of Los Angeles and governor of California. Their political progress has also been held back by gerrymandering, to create minority districts, and by an unnecessarily complicated voter-registration process.

The last caveat is the biggest of all: education. California's schools are inextricably tied up with immigration. Only one in three children in California's public schools is white; 45% are Latino. In Los Angeles, the proportions are 10% and 70%, respectively. All the optimistic predictions about the integration of Latinos make sense only if their schools teach them English and provide them with enough skills to let them escape day-labour jobs.

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Education 101

Apr 29th 2004
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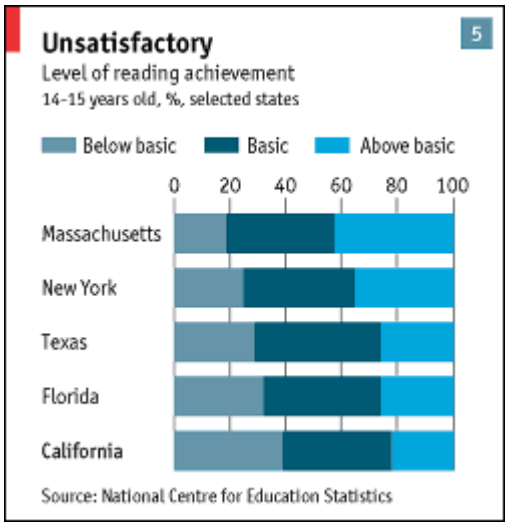
Schools are getting better, but not fast enough



SPEND a day with Richard Alonzo and, regardless of your political sympathies, your blood will begin to boil. This quietly determined Latino runs District F, the most difficult beat in the huge Los Angeles Unified School District (LAUSD). Mr Alonzo is responsible for 60 schools, 3,000 teachers and 65,000 students, 98% of whom come from minorities. And despite a biggish jump forward recently, the district provides plenty of shocking evidence of the shabby way the richest state in the world's biggest economy treats poor children.

In Belmont, a huge high school with 5,500 pupils, security guards at the door, gangs in the classrooms and a 40% graduation rate, it is hard to imagine how children could ever learn anything in such a forbidding place. Yet even the better schools seem overrun. Placencia Elementary School, for instance, is full of smiling pupils, but like many other schools it does not have proper terms; instead, it follows a “year-round” schedule, with the students being rotated through the classrooms (three groups in, one out). But at least the pupils are being taught close to home. Every day, 6,000 children from the Belmont area are bused out to other districts. “Can it be good,” Mr Alonzo asks, “for a five-year-old to be woken up at 6am to travel two hours for a half-day of education?”

District F demonstrates what one leading Democrat calls the “these-are-not-our-children” attitude of white voters. With their own children now either educated privately or safe in smaller suburban districts, they have not stumped up the cash to build the schools needed to educate the new browner-skinned arrivals. As Roy Romer, the head of the LAUSD, points out, the same community found the money to build the sparkling Disney Concert Hall and the Staples conference centre.

Back in the 1960s, California had the fifth-highest spending-per-pupil rate in the country. Now it ranks 30th and spends $7,240—around $600 below the national average and $4,300 below the level in New York. Yet its education challenges are greater than those of any other state. Not only are so many of its pupils learning English as a second language, but many of them are poor and their parents move around a lot. In many urban high schools, fewer than one in 20 students of an entry class will graduate from the same school.

The results are depressing. Californian students score below average on every national test; only around half California's students are proficient in the basics. In 2002, California ranked 43rd in verbal SAT scores and 32nd in mathematics. One in five Californians aged 25 and over lacks a high-school diploma—the ninth-worst figure nationally and hardly a good omen for the knowledge economy. “Sooner or later we have to face up to the fact that most of our future workforce is already here,” says Perry Wong of the Milken Institute.

To be fair, the scores have got a little better recently, particularly at elementary level. Jack O'Connell, the state's Democratic superintendent of public instruction, attributes this to the reduction in class sizes and tougher standards. At LAUSD, Mr Romer, a punchy former governor of Colorado, has pioneered a system of “diagnostic testing”—frequent small tests that allow Mr Alonzo to track exactly how his students are doing and deal with problems early. Voters are also approving school bonds again. Mr Alonzo is building 22 new schools in District F, and this time the schools will be smaller ones.

But what good will the shining new schools be if they are staffed by unsackable teachers and no politician is accountable for them? Conservative critics see their school system as an overindulged public-sector

lobby, not a pauper. Yes, they admit, California has slipped down the spending ratings, but spending per pupil has tripled in real terms since the 1960s; and thanks to Proposition 98 in 1988, 40% of the budget has been going to the schools ever since. Chester Finn, an education expert at the Hoover Institution, points out that over the past 30 years Californian business has been getting ever more out of ever fewer staff; yet California's education system has become ever less productive.

Enemies of promise

Many of the worst things about LAUSD, including the fact that the monolith exists at all, have nothing to do with money, and a lot to do with the intransigence of the public sector—particularly the teachers' unions. This morning, Mr Alonzo is celebrating because he has at last managed to remove one appalling teacher. It has taken nearly three years and several hundred thousand dollars. Altogether, he reckons the district has about 20 such people—drunks, chronic absentees and so on—to deal with, but once a teacher has tenure, he or she becomes extremely difficult to remove. As for rewarding his stars, Mr Alonzo is frustrated by rules that make promotion almost entirely dependent on seniority. Helpful though Mr Romer's diagnostic testing is, it is limited by the unions' proviso that it must not be used to assess staff or pupils.

As governor of Colorado, Mr Romer was answerable to the electorate every four years; now he reports to the seven-strong LAUSD board. “Everyone is a great human being,” he notes. “But they are all running for higher office.” Elections for school districts are dominated by the teachers' unions, who have the most cash to spend and the most to lose from reform.

New York recently made its schools chief accountable to the mayor. There is no sign of that happening in LA or San Francisco—not least because, ever since Proposition 13, school funding has been so reliant on Sacramento. There is even duplication at the top: Mr O'Connell is the head of the Department of Education, but Mr Schwarzenegger also has an education secretary, Richard Riordan.

Mr Riordan seems keen on pushing more responsibility down to principals, which is fine, but pushing more power down to parents would be even better. The teachers' union has fought a rearguard action against choice, but there is a growing number of successful charter schools (public schools that are privately run). Mr Alonzo, for one, is all for them. “Anybody who is keen to build a school in this district deserves welcoming.”

The most radical form of education reform—vouchers that allow poor parents to choose where to spend their money—has made no progress in California: two initiatives have been fiercely beaten back. Mr O'Connell can barely bring himself to mention the word. Even Jerry Brown, who has pioneered charter schools in Oakland, knows better than to offend the unions: “Whoa,” he smiles. “You can't go there.” Mr Schwarzenegger also steers diplomatically clear of the subject.

Certainly, the refusal to introduce more competition to the system is encouraging informal markets to sprout up around it. For instance, as long as the state refuses to pay good teachers more than bad ones, the good ones will move to nice schools, typically in small wealthy districts.

Then there is the house-price effect. Ross DeVol at the Milken Institute points to the difference between Woodland Hills, which is inside the LAUSD (so anybody who can afford it spends $20,000 a year to send their child to a private school), and Calabasas, which has a smaller, well-run school district. As a result, the sort of house that would cost, say, $650,000 in Woodland Hills will cost $975,000 in Calabasas. When they were looking for a new home, Mr DeVol's statistically minded wife constructed a graph plotting fourth-grade test scores against local house prices: the correlation was depressingly close.

Education epitomises the state's problem with government. There is the wide gap between the public and the private systems; a public-sector union adamantly protecting its turf; an incoherent administrative map; and a lunatic funding system. But there is also a desperate desire for something to happen. Most teachers want to get rid of underperforming colleagues; most politicians want somebody to be responsible for schools; and most immigrants definitely want to learn.

Mr Alonzo, for one, remains indefatigably optimistic. At Placencia, a group of kids gather round. “What do you speak at home?” he asks. “Spanish and English,” they all shout in reply. “Look,” he beams, “we are winning.”

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A good start

Apr 29th 2004
From The Economist print edition

The Terminator has the right ideas—but what about his glass back?

Getty Images

Smart enough?

TO UNDERSTAND the importance of Arnold Schwarzenegger in Californian politics, consider an event deep in hostile territory: a small fund-raising concert in San Francisco's trendy warehouse area in February for Kamala Harris, the city's new district attorney. At the time, California's most liberal enclave, the only big city to vote against the recall, had just started issuing licences to gay couples to get married, causing a spat with the new governor. Mr Schwarzenegger, although personally tolerant towards gays, firmly told Gavin Newsom, the new mayor, that letting them marry was against state law.

The concert had an impeccably leftish tone. On stage a local rock star did his stuff, while a cosmopolitan crowd of rich white trustafarians and multicoloured politicians drank, nibbled and chatted. They all backed their new mayor on gay marriage, and nobody admitted to having voted for Mr Schwarzenegger; yet an astonishing degree of goodwill towards the governor was in evidence. Shouting above the music, Ms Harris hailed him as “at last a Republican we can deal with,” pointing to his liberal stance on most social issues, including abortion and the environment. Despite his public row with the governor, Mr Newsom, who like Ms Harris is seen as a moderniser in his party, backed this view. “On a whole range of positions, the governor and I agree. We are both problem-solvers.”

Mr Schwarzenegger is seen as something of a political novelty. The way in which he was selected (of which more below) was indeed extraordinary. But his politics have something in common with his most famous cinematic creation. Like the Terminator, Schwarzeneggerism is a remodelled, highly efficient time-traveller.

On this particular time-trip, the governor comes from his party's past. Between 1966 and 1994, the party of Richard Nixon and Ronald Reagan won six out of eight gubernatorial elections in California by sticking to a brand of western conservatism that was fiscally conservative but socially tolerant. But then the state party suicidally decided to adopt a “southern” approach to race and also to moral issues, with Christian conservatives insisting in primaries that candidates adopt hardline positions on abortion and homosexuality.

Symptomatically, in 2002, the Republicans rejected the Bush White House's suggestion that they choose Richard Riordan, the moderate former mayor of Los Angeles (who led Gray Davis in the polls), in favour of Bill Simon, a political novice whose main appeal was his anti-abortion stance. Mr Davis duly survived.

To anyone attending the 2002 Republican state convention at Anaheim, with its rows of elderly white zealots, the chance that the party would ever select a pro-choice, hedonistic actor seemed only a little higher than that it would choose Bill Clinton. From Mr Schwarzenegger's point of view, the beauty of the recall competition, forced on Mr Davis by a signature-gathering effort last summer, was that he did not have to win a primary. Instead, Californians first had to decide by a straight majority vote whether Mr Davis should go; if he fell, the prize would go to the winner from a field of 130 candidates.

Mr Schwarzenegger, advised by a team of old Republican moderates including Mr Riordan, George Shultz and Pete Wilson, the most recent Republican governor, waited until most of the leading Democrats had loyally ruled themselves out of the competition and then pounced. After a few wobbles (those stories about women, mainly) he easily elbowed aside Cruz Bustamante, the Democratic lieutenant-governor,

and Tom McClintock, a Republican hardliner, in the second round.

Mr Schwarzenegger's victory certainly owed something to both star appeal and anger with the status quo. But he also stuck to the principles of old-style western Republicanism. He railed against big government, but made it clear that his concept of freedom extended to people's personal lives, including, crucially, the freedom to choose abortion. Despite his groping past, Mr Schwarzenegger beat Mr Bustamante solidly among women (45-35%).

Remarkably, the multimillionaire muscle-man managed to convince ordinary Californians that he was more like them than were their politicians. This was partly a matter of aspiration: Mr Schwarzenegger sold the story of a poor immigrant who came to California, made a fortune and married one of the brighter Kennedys. But he also hammered on about his willingness to solve problems and to ignore partisan squabbles. “Sure, Arnold is a Republican,” says Warren Beatty, Hollywood's most experienced actor-politician. “But he has some Democrat advisers, some Democrat leanings and a famous Democrat wife. He shares at least some beliefs with virtually everybody in the state.”

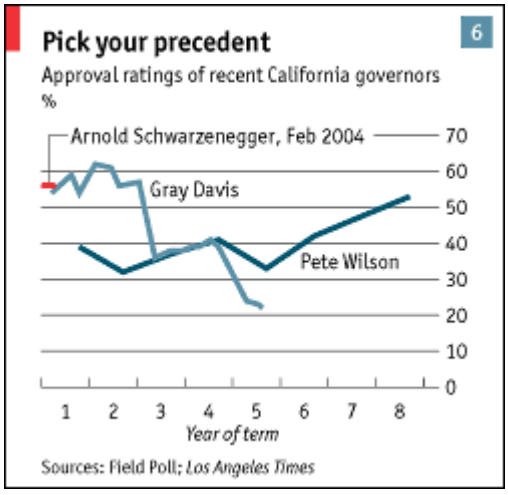
Since the election, Mr Schwarzenegger has stuck to the centre, whilst threatening extremists on either side that he will use initiatives to get his way. The rapid passage of Propositions 57 and 58, whatever their fiscal merits, was a big political coup, not least because he got so many Democrats to support them. “Most governors begin with a limited amount of political capital and have to spend it. Arnold actually increased his,” argues Sherry Bebitch Jeffe of the University of Southern California.

Carry a big axe

This aggressive centrism has left the two wings of Californian politics in disarray. Conservative Republicans are still in a state of shock, unsure whether to cheer or weep, their discomfort lessened only by the plight of the Democrats. Barely a year ago, California was a one-party state; the Democrats still control the legislature and most of the statewide posts, but they are no longer running the show. “We are like headless chickens,” admits one of them.

For the moment, it is hard to find anyone in Californian politics who has a bad word to say for Mr Schwarzenegger in public. He has charmed people, bringing a touch of glamour to a town that has not seemed cool since Jerry Brown's days; he has a first-rate team of advisers; and, just as in Hollywood, where he remains as much admired for his business sense as for his acting, nobody makes jokes about dumb action heroes any more.

“He is a very quick learner,” says John Hein, the veteran teachers' union lobbyist in Sacramento, who got to know the governor when they both worked on Proposition 49, an after-school initiative that Mr Schwarzenegger sponsored in 2002. His direct approach also seems to have gone down well. Steve Westly, the Democratic state comptroller, says new governors usually summon department heads to their office; Mr Schwarzenegger made a point of visiting people on their own patch.



But how much longer can this continue? Mr Schwarzenegger remains a centrist in a town of zealots. And for all his macho talk about banging heads together, he has not yet forced either party (or indeed the teachers' unions) to do anything really difficult. Workers' compensation was a struggle, but most Democrats knew that some form of reform was inevitable. “So far, Arnold has provided a soft place for an awful amount of people to land,” one veteran observes. “But all honeymoons end.”

Mr Schwarzenegger's mettle is still unproven in a real political scrap. He does have some Reaganesque traits, notably a very Californian optimism and an ability to sell complicated proposals in a simple way: for example, he compared his bonds to clearing credit-card debts. But the Gipper had been involved in active politics for much longer and had a much more clearly defined ideological heartland.

Despite his staff's insistence that Mr Schwarzenegger has a firm grasp of the issues, he conspicuously runs away from anything that might be regarded as a probing conversation. (He was too busy to see *The Economist*, but somehow found time to guest-edit a fitness magazine.) And, as anyone who has been to

a Hollywood dinner party can attest, there are plenty of tales from his “playful” past for his enemies to return to. “He may look like the Terminator from the front,” says one mogul. “But he has got a glass back.”

One friend of Mr Schwarzenegger's compares him to Bill Clinton, another charming, flawed centrist. For the moment, at least, they are not in the same league. Mr Clinton not only knew his stuff and had a taste for debate; he was a politician, used to taking hits. Mr Schwarzenegger still remains primarily a star, used to fake punches thrown by stuntmen.

Given these strengths and weaknesses, momentum will surely be the key to Mr Schwarzenegger's success. In much the same way that a good action movie seldom leaves you much time to watch the details, a successful Schwarzenegger governorship will rely on pushing forward—and solving problems.

The momentum he has gained from Propositions 57 and 58, and his deal on workers' compensation, should just about deliver him a budget for 2004-05: the Democrats have already braced themselves for spending cuts. The big question is: what next? After all, even with deals on the budget and on workers' comp, Mr Schwarzenegger will merely have moved the state back to where it was in 1998. It will still have lousy schools and unaccountable government, and the next budget crisis will still be around the corner.

Mr Wilson puts it simply: “Arnold, you have huge political capital. Use it to fix what is wrong and you will acquire more. If you don't use it, it will evaporate.” The next article will presumptuously offer Mr Schwarzenegger a longish to-do list.

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Be bold

Apr 29th 2004
From The Economist print edition

A blueprint for reform

THE new governor has tried to have it both ways on serious governmental reform. On the one hand, he has talked about structural change and "blowing up boxes". On the other hand, when one of his advisers, Warren Buffett, suggested blowing up the biggest box of all, the property-tax-cutting Proposition 13, Mr Schwarzenegger told him at a press conference to start doing press-ups as a punishment.

Yet reform will be hard to run away from, for two reasons. First, as Mark Baldassare of the Public Policy Institute of California points out, reformist ideas will push their way into politics anyway. In November, there may be a ballot initiative trying to give local government a bigger share of the tax take and another trying to switch the state to Louisiana-style "open" primaries, in which people from both parties can vote (meaning that more centrists may be chosen to go on to the general election). Second, even with a new budget, it will not take voters long to realise that little has changed. Sooner or later, another crisis will blow up, and they will know that Mr Schwarzenegger has failed to avert it.

A leap of the imagination

What should he do? Given the vested interests lined up against most individual pieces of reform, it will be difficult to get anything done piecemeal. Instead, Mr Schwarzenegger should bundle as many things as possible into one take-it-or-leave-it package. This would include:

•**The electoral system**. Proper redistricting by an independent commission could be combined with two harder-to-sell ideas—an increase in the size of the legislature (to get rid of the unmanageably large districts in the state Senate) and a relaxation of term limits (to train savvier politicians). One solution might be to switch to a unicameral system with a single chamber of 120 members, limited to a term of 14 years, the same period they could serve consecutively in both chambers at the moment. The introduction of open primaries should also be considered.

•**Statewide offices**. The superintendent of public instruction, the treasurer, the insurance commissioner and all the other unnecessary duplicated offices should go. The lieutenant-governor should run on the same ticket as the governor.

•**A reallocation of local and state tax revenues.** Cleaning up the mess left behind by Proposition 13 will be difficult, and there will always be some duplication between state and local government because of the need to equalise the revenues of richer and poorer cities and counties. But in principle, at least, the system would be more transparent if different taxes went to different levels of government (eg, property tax to local government, income tax to state and so on).

•**Reorganisation of administrative areas**. This will involve drawing up a more sensible map, allocating specific tasks to different layers of government. Thus the state might be responsible for universities, water and welfare; regional authorities for transport, the environment and planning; and cities for police and schools (with mayors held accountable for their performance). This might entail removing both counties and school districts as unnecessary layers of government.

•**Initiatives.** The number of signatures needed to launch an initiative should be increased. More importantly, time limits should be introduced for all referendums, particularly ones that seek to determine the shape of government, forcing either the voters or the legislature to decide whether to

renew the measure.

As he reads this list, perhaps in the special smoking tent outside his office, Mr Schwarzenegger will no doubt cough over his cigar. Many other Californians will think it looks suspiciously close to a parliamentary model—more like the sort of thing that a proper country might have. It may seem odd to start governing California as if it were a full-fledged nation; but it is surely odder to continue governing it as if it were a small 19th-century colony. The country that has pioneered so much private-sector experimentation needs to translate some of that boldness to the public sector. Otherwise, one of the world's most interesting, entertaining, beautiful and dynamic places will throw away the future its inhabitants deserve.

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The internet

The weakness of Google

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Despite the hype around its IPO, Google is not certain to be an internet winner

THIS week, Google, a secretive private firm that is also the world's favourite internet search engine, reached a regulatory tripwire that forces firms with more than 500 investors to disclose almost as much information as firms listed on America's stockmarkets do. In Silicon Valley, where firms often pay workers in shares as well as cash, this is common and often prompts firms to go one extra step to an initial public offering (IPO) of shares. As a result, as *The Economist* went to press, Silicon Valley and Wall Street were rife with speculation about what Google might be worth as a listed company. Not since the Netscape IPO in 1995, which kicked off the dotcom era, have techies been so excited.

But the IPO hype around Google and its likeable and soon-to-be fabulously rich founders, Sergey Brin and Larry Page, obscures a more subtle point. Not only is Google less strong than it looks, but an IPO might make it even weaker at a crucial moment, since Google is about to face simultaneous onslaughts from two fearsome rivals—Yahoo!, an internet portal that offers free e-mail and other services, and Microsoft, computing's software superpower, which runs an internet portal of its own.

It appears that Messrs Brin and Page, aware of the bad timing, have been anything but keen on a speedy IPO. Instead, the push for a listing seems to be coming from two venture capitalists on the firm's board—John Doerr of Kleiner Perkins Caufield & Byers, who also backed Netscape, and Michael Moritz of Sequoia Capital, who also financed Yahoo! and PayPal, an online-payment firm now owned by eBay, a hugely successful internet-auction site.

An IPO is “a tremendous distraction”, says Peter Thiel, who co-founded PayPal and ran into the same regulation in 2002, leading him to launch a PayPal IPO and then, soon after, to sell the entire company to eBay. The pressures of quarterly reporting and transparency are huge, says Mr Thiel, adding that “the investment bankers benefit most” (in Google's case, that would be Morgan Stanley and Credit Suisse First Boston). Google does not need capital, says Mr Thiel, but it does need to keep a laser-like focus on its rivals.

In search of excellence

Google owes its massive success to two events. First, Messrs Brin and Page came up with what was for some time the best algorithm for searching web pages. Second, Eric Schmidt, whom they hired as chief executive in 2001, figured out how to “monetise” Google's popularity by selling small and unobtrusive

advertisements on related topics, so-called “sponsored links”, alongside the search results.

In search, Google is now vulnerable because the barriers to entry to its market are low. This is the big difference between Google and eBay, the firm held up by the bullish analysts as a valuation benchmark. The auctioneer keeps ahead of rivals due to “network effects” that draw traders to the most liquid market, whether in shares, cars or second-hand junk. In search, network effects do not apply. Hence, in the late 1990s, Google was able to displace the cognoscenti's engine of choice, AltaVista. Hence, too, Google may in turn be ousted—perhaps by a bright new upstart, such as Mooter, an Australian engine that draws on psychology to improve search results, or, more likely, by Yahoo! or Microsoft.

Until this year, Yahoo! was a partner of Google. It used Google's technology to run its own searches, just as other portals, such as AOL, still do. This did wonders for Google's market share: at its peak, some 75% of all internet searches touched Google's technology. But Yahoo! was only biding its time. It bought several rival search technologies, including AltaVista and Inktomi, which its engineers souped up. The key advantage that Yahoo! now has, says Jeff Weiner, its search boss, is the registration information from more than 100m users of its e-mail, travel and other services. This should allow it to tailor searches more closely to the needs of users. In February, Yahoo! finally sacked Google and started using its own technology. Now Google's algorithm touches a bit over half of all searches. Yahoo! is close behind.

Microsoft is also developing its own search technology and ultimately plans to integrate it into Windows, the operating system that runs 94% of the world's personal computers. The next version of Windows, code-named Longhorn, is expected in 2006 and will have search functions embedded deep inside it. Users will no longer need to care whether the stuff they are looking for is on the web, in their e-mail, or in their Word documents. In essence, Microsoft aims to make Google irrelevant by helping people mine data wherever it is.

Google now knows that it must match Yahoo! by gathering more information about users and making them more loyal to its website. Matching Microsoft will require something even bolder. Google has decided to try to turn its own technology into, in effect, a new operating system, which will run on the internet rather than the desktop, so making Windows irrelevant. Microsoft and Google, in other words, share the idea that users should no longer care whether files are located on a personal computer, a remote computer, a digital video recorder, a cell phone, a car stereo or any other connected gadget; but they clash because each wants its own software to do the locating and retrieving.

This explains Google's latest innovation, announced on April 1st: Gmail. A free e-mail service, it will offer many times the storage capacity (1 gigabyte) of either Yahoo! or Microsoft's Hotmail. To make this service “free”, Google will raise money by putting advertising links into the e-mails. To tackle Yahoo! it will try to establish a continuous relationship with users. To fight Microsoft it will encourage users to store their files not on their personal computers but on Google's remote machines.

Alas for Google, its strategy got off to a bad start. Much to its own shock—the firm considers itself “the nice guys”—Gmail's e-mail-crawling, necessary for choosing the most fitting ad-links, has upset privacy groups. This is awkward. To become the storage medium of choice, Google, Microsoft and Yahoo! must each, above all, convince users that they are trustworthy.

But Google has another disadvantage. Microsoft is still primarily a vendor of software licences, earning fat profits that it can use to subsidise a search war almost indefinitely. Google relies for its revenues on selling sponsored links. On search pages, this is a $3 billion market growing by 20% a year, according to US Bancorp Piper Jaffray, a bank. But competition is fierce, not only with Yahoo!'s advertising arm, Overture, but with smaller players such as FindWhat.com and Kanoodle.

“The search advertising market is mature,” says Mark Josephson, Kanoodle's marketing boss, adding that future growth can come only from placing sponsored links on the 95% of web pages that contain not search results but content. Google knows this. It is trying to use its algorithms to crawl newspaper articles, web journals and so forth to identify their subject area and place “contextual” ads. Its problem, says Mr Josephson, is that “advertisers are not buying keywords anymore, they're buying topics,” which requires a different approach. As Google spreads out from search pages, he says, its people are “getting further and further away from their expertise.” In trying to morph into an operating-system firm or online ad agency, Google is less a leader than a novice.

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Comcast and Disney

Michael Eisner fights on

Apr 29th 2004
From The Economist print edition

The most uneventful bid in media history fizzles out

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THIS has been a magic week for Michael Eisner, boss of Walt Disney, who has been fighting attempts to unseat him, one way or another. Comcast, a giant cable firm, announced the withdrawal of the $66 billion hostile bid that it made in February for Disney. That good news for Mr Eisner came one day after Disney's board affirmed its full support for him following a two-day meeting. Mr Eisner's position had seemed precarious. At Disney's annual meeting in March, 45% of shareholders failed to support his re-election to the board, and he was stripped of his role as chairman. Now he can congratulate himself that, on the surface at least, things are back to normal.

AP

Kill Bill, save Michael

Comcast's president and chief executive officer, Brian Roberts, explained his decision by pointing to Disney's lack of interest in merging the two firms. “Being disciplined means knowing when it is time to walk away,” he said. “That time is now.” Comcast did not want to lose its reputation as a tough, savvy deal-maker by offering a price that would force Disney's board to recommend the deal to shareholders. For each Disney share, Comcast had offered 0.78 of its own, initially a premium of 10%. But its shares fell by as much as 17%, and Disney's rose by up to 16%, so the offer has been out-of-the-money ever since.

Part of the problem, says a banker close to Comcast, was that it did not do a good enough job of convincing its own shareholders that merging the two firms would produce more than the sum of the parts. Comcast's management team is one of the best-regarded in the media industry. But the failure of such big media mergers as Time Warner's with AOL and Vivendi's with Universal has made investors sceptical of attempts to achieve synergies by marrying content and distribution. They also feared opposition in Washington, DC, where media consolidation is a hot issue.

Ironically, says another banker, the Comcast bid may actually have strengthened Mr Eisner's position, at least until now, because Disney's board wanted to avoid anything that might have smacked of weakness, such as a change at the top. Now, he says, perhaps the board will be emboldened to replace Mr Eisner before his contract ends in September 2006. It will meet six big public pension funds on May 21st to discuss performance and leadership. The independent directors, led by the chairman, George Mitchell, may be pressed to start a search for a successor.

Yet the board and most investors now seem happy with management's promise to deliver 40% growth in profits from continuing operations this fiscal year and double-digit growth to 2007. Disney's theme parks are enjoying a strong recovery from their post-September 11th slump. ESPN, its popular sports network, is performing well. Some recent movies—“The Alamo” and “Home on the Range”—may require write-downs in Disney's accounts thanks to poor takings, but this will be partially offset by the success of its Miramax subsidiary's “Kill Bill 2”. On the other hand, there is no evidence that Disney's two big problem areas—animation and ABC, Disney's broadcast network—are being repaired, says Tom Wolzien, an analyst at Sanford Bernstein. ABC languishes in fourth place in the ratings and is losing money, a failure that Mr Eisner acknowledged by firing its top two managers last month.

If Disney falters again, a new bidder may emerge or, indeed, Comcast may return. Mr Roberts has wanted Disney for over five years, and is the sort of man to play a long, patient game. Comcast may now prefer to buy MGM, a film studio that Sony may be about to bid for, or Adelphia, a struggling cable rival. But even if it did, it could still pursue Disney at a later date. Mr Eisner looks safe—but only for now.

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Telecoms

Decapitated

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Despite sacking three top executives, Nortel is not doing too badly

IS THERE no end to the turmoil in telecoms? On April 28th Nortel Networks, a large Canadian telecoms-equipment maker and a darling of investors during the recent tech bubble, said that its chief executive, chief financial officer (CFO) and controller had all been “terminated for cause” amid an investigation into accounting irregularities. The posting of its results for the first three months of 2004, due on April 29th, was delayed. Nortel's CFO and controller were already suspended, while America's Securities and Exchange Commission examined Nortel's books. But it comes as quite a shock that Frank Dunn, the chief executive, has been fired too.

Mr Dunn was previously the CFO, becoming boss in 2001 after the bubble burst. As accounting scandals rocked the telecoms industry, putting the CFO in charge seemed the right thing to do. He embarked on a savage restructuring programme, cutting around 60,000 jobs and shifting Nortel's focus away from the optical-networking gear that had sold so well during the bubble, when dozens of telecoms firms raced to build shiny new networks.

This strategy seemed to have paid off: last year the firm reported a return to profit, its share price began to recover, and in January Merrill Lynch upgraded its shares to a “buy”. Not bad for a firm that had seen its market capitalisation fall from a peak of $250 billion to less than $2 billion two years later. Now Nortel says that last year's results will have to be restated. This seems to suggest that the recent emergence from bankruptcy of MCI, a large network operator formerly known as WorldCom and the poster child for telecoms scandals, did not, after all, signal the closing of a shameful chapter in the industry's history.

Yet the picture is not as gloomy as it appears. For even when the restatement is taken into account, it seems that Nortel did indeed return to profit in the second half of last year. It is doing particularly well at selling both mobile-phone base-stations and voice-over-internet-protocol (VoIP) equipment, two growth areas in an industry that is now showing renewed signs of life. “The industry is resurging, especially in the areas where Nortel is concentrating,” says Blaik Kirby of Adventis, a Boston-based telecoms consultancy.

Indeed, says Mr Kirby, of all the telecoms-equipment vendors, Nortel, along with Cisco, has done the best job of repositioning itself for future growth. It has wisely concentrated on growth areas such as VoIP, wireless, broadband DSL equipment, and a fancy new technology called MPLS that is supposed to reduce the cost and complexity of running large operators' networks. Meanwhile Ericsson, the largest vendor of wireless infrastructure, reported last month that its profitability was back to 1999 levels. Although Nokia's share price fell recently when it revealed disappointing handset sales, its infrastructure division beat expectations. It is too soon to say that Nortel and other telecoms-equipment vendors are fully restored to health. But despite this week's bad news, they certainly seem to be on the mend.

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DaimlerChrysler

The wheels come off

Apr 29th 2004 | FRANKFURT, HONG KONG AND TOKYO
From The Economist print edition

Without Mitsubishi, whither Daimler Chrysler's Asian strategy?

JÜRGEN SCHREMPP, boss of DaimlerChrysler, faced calls for his resignation in Germany this week, after the car maker's surprise decision to freeze, or even sell, its 37% shareholding in Mitsubishi Motors and to pump no new money into the Japanese firm. Mitsubishi's shares and credit-rating plunged on the news. Its president, Rolf Eckrodt, quit on April 26th. Although Daimler has at last begun to extricate itself from a hopeless situation, the move has raised serious doubts about its strategy. Mr Schrempp's critics say that his declared ambition, to make the group a Welt AG, or global company, has hit a brick wall. More turmoil seems likely at the top of Daimler.

The most serious calls for Mr Schrempp to quit came from Michael Schneider, director of Deka Investment, one of Germany's biggest fund managers, and from *Handelsblatt*, a business daily. Ekkehard Wenger, a shareholder activist, also threatened Daimler's supervisory board with a charge of breach of trust for misleading shareholders when extending Mr Schrempp's contract until 2008 on April 7th. The board gave this three-year extension hastily, a year ahead of schedule, knowing that his global strategy was about to fall apart, suggested Mr Wenger. This is strongly denied by the firm.

EPA

Waving goodbye?

Daimler now needs to come up with a new Asian strategy, and fast. Mitsubishi was supposedly a crucial piece of the old strategy, not least as a supplier of technology for Daimler's global car designs. But unlike Renault, its French rival, which has revived Nissan Motor, Daimler was never able to whip Mitsubishi into shape.

Mitsubishi's ownership structure did not help: other firms in the Mitsubishi group of companies—Mitsubishi Heavy Industries, Mitsubishi Corp (a trading company) and Bank of Tokyo-Mitsubishi—retained at least 25% of its shares. But Daimler deserves much of the blame. Unlike Renault, it did not send in its best managers to turn the firm around. It approved Mitsubishi's “triple-zero” incentive campaign in America, which resulted in massive losses. Scandals, such as cover-ups of defects in vehicles and tyres, damaged Mitsubishi's brand. And even its best products have been matched by rivals. In the year to the end of March 2004, Mitsubishi expects to record a ¥72 billion ($660m) net loss.

Mitsubishi is now expected to unveil yet another revitalisation plan by late May—but is likely to have to do so without several more of its German managers. Although other member firms in the Mitsubishi group are scrambling to rescue it, none has the expertise to run a car firm. Unless a new buyer emerges, its survival will depend on the group—along with, perhaps, the government and chums from outside the group—finding the ¥700 billion or so reportedly needed to turn around the firm.

Sources at Daimler's Stuttgart headquarters play down the likely impact of all this on its Asian strategy. Its Mercedes unit is still thriving in Japan. Daimler also owns 65% of Mitsubishi Fuso Truck and Bus, a spin-off which, the sources say, is “very profitable”. In China, Mercedes-Benz cars are all the rage among the moneyed elite.

But Audi and BMW are now pulling ahead of Daimler in China, thanks in part to local production and distribution. Last year around 9,000 Mercedes were sold in China, all imported, says Geoff Liu, an analyst at Automotive Resources Asia. This compares with 20,000 BMWs (some made locally) and 60,000 Audis

(almost all locally made). Belatedly, perhaps, given how fast China's car market is growing (luxury volumes rose by almost 110% in the year to March 2004, while the mass segment, though slowing, rose by 45%), Daimler is now responding. In September, it signed a €1 billion ($1.2 billion) deal with Beijing Automotive Industry Holding Company (BAIC) to make, from next year, Mercedes cars and trucks in China, with a target of 25,000 luxury cars by 2012.

And yet Daimler's efforts in China may threaten another crucial Asian relationship, with South Korea's Hyundai Motor Company. Daimler has a 10.5% stake in Hyundai, with an option to raise it to 15%, and a joint-venture with Hyundai and Mitsubishi to make engines. But Hyundai also had an exclusive long-term contract with BAIC to make passenger cars in China. It was so incensed at Daimler's agreement last year with BAIC that it put talks with the Germans on ice—although it said this week that it is still discussing potential further cooperation with Daimler on a project-by-project basis. If Hyundai backs off, as seems quite likely, Daimler's Asian strategy really will be in tatters.

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Doing business in Libya

From Green Book to greenbacks

Apr 29th 2004
From The Economist print edition

Foreign companies are hoping to profit from Colonel Qaddafi

AP

Yes, you can be sure of Shell, Muammar

IT HAS been a mixed week, business-wise, for former rogue states. With each bomb or kidnap, Iraq is losing its appeal to foreign firms. Libya, by contrast, has never seemed so attractive, now that its leader, Muammar Qaddafi, has used his charm—and lots of his money—to get lifted most of the international sanctions in place during the past two decades.

Mr Qaddafi now wants foreign firms to help liberalise Libya's economy. Oil output is roughly half what it was in the 1970s. Fathi ben Shatwan, head of the energy ministry, says Libya will need some $30 billion of investment in the next decade.

Up for grabs are lucrative exploration and production rights. Libya has 36 billion barrels of proved oil reserves (and claims there may be 100 billion) and around 40 trillion cubic feet of gas reserves. The cost of recovering the oil is low and the country is well located for exporting to Europe.

Representatives of the Oasis group of oil firms (ConocoPhillips, Marathon and Amerada Hess) will meet Libyan officials on May 9th to discuss an extension of their existing concession. Their Libyan assets have been “held in trust” by Mr Qaddafi's government since 1986. Occidental has also expressed an interest in resuming operations, having written off its Libyan assets after the imposition of sanctions.

In March, Royal Dutch/Shell signed a preliminary agreement that could mean it invests an initial $200m in gas exploration. Its negotiations were helped along by Tony Blair, Britain's prime minister, during a visit to Tripoli in March. Total's similar negotiations may get a boost when France's president, Jacques Chirac, visits in June.

After a long “guided revolution”, Libya's health-care, education, transport, aviation and tourism sectors desperately need investment. Libya's strong historical ties with Britain could help British firms, says Marcus Courage of Africa Practice, a consultancy. BAE Systems is in talks to rebuild Tripoli airport and manage air-traffic control. Balfour Beatty has expressed interest in the construction of two railway lines.

Although Mr Qaddafi has shelved his “Green Book”, which among other things declares that “recognition of profit is an acknowledgment of exploitation”, political meddling remains rife. Mike O'Brien, a British minister, recently told Libyan officials what foreign business wants: a transparent tendering process; respect for contracts and the rule of law; and a promise to deal with “issues of corruption”. Without that, foreign firms may well ask if the Mad Dog truly is serious about business.

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Energy in India

Can Dabhol be fired-up again?

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Efforts to restart a failed energy project

ON THE shore of the Arabian Sea in western India stands Dabhol, a deteriorating $2.9 billion monument to the excesses of the 1990s, when foreign power firms swept across Asia, persuading eager politicians and bureaucrats to let them set up generating plants at inflated prices. Dabhol is a 2200MW power project shut in 2001 by Enron and other investors after the local Maharashtra state government's electricity authority fell $240m behind with its payments. This undermined India's claims to be a safe destination for foreign investment. The project has since remained closed, mired in litigation.

That could change. Encouraged by the Indian government, efforts have begun to untangle things and get Dabhol generating again. The idea is that those involved agree to abandon their litigation and take a "haircut"—a big reduction in their various claims—in order to lower the price of electricity from Dabhol to a commercially, and politically, acceptable level.

A clutch of Indian banks with an exposure of about $1.4 billion, led by the Industrial Development Bank of India, is offering to buy $390m of debt (including interest) from 25 foreign lenders, led by ABN-AMRO. The two sides have met with America's Overseas Private Investment Corporation (OPIC), which is both a lender and guarantor. They last met in Singapore on April 23rd and agreed to negotiate on a commercial basis, irrespective of current litigation, and to meet again in London on May 12th. The Indian bankers have made an initial offer to pay 40% of the nominal value of the foreign loans.

If a deal is agreed, the Indian banks and OPIC will organise a tender of the debt—and, with it, potential control of Dabhol. Four likely bidders have declared an interest, partly attracted by the project's liquid gas terminal: BP, in a consortium with two Indian partners, Tata and GAIL; Royal Dutch/Shell; British Gas; and Reliance.

There remain plenty of complications. Reliance, India's most politically influential firm, which has interests in both gas and power, would probably rather the rescue efforts fail than another firm win, according to sources close to the deal.

The buyer of the banks' debt would also have to buy out General Electric (GE) and Bechtel, the project's main suppliers and contractors. Each originally had a 10% equity stake. They recently raised this to a combined 85% by agreeing with an American bankruptcy court handling Enron's affairs to pay $20m for the collapsed energy company's 65% stake.

There is a risk that this purchase will be challenged in the Indian courts. But, more importantly, both GE and Bechtel are miffed at the way they have been treated by the Indian authorities and say that they want the full $240m value of their original equity stake, even though their deal with the bankruptcy court values Enron's stake at a fraction of its original price. They also want the $20m they are paying to Enron's creditors, plus $140m for outstanding contract payments and as-yet-unknown costs for renovating the project's 744MW first stage and finishing the uncompleted stage two. Others involved protest that this is greedy and want GE and Bechtel to share in their haircut. But the two American giants have powerful leverage. They have outstanding legal and arbitration claims totalling at least $2.4 billion—and they own drawings, computer chips and know-how, without which Dabhol will stay closed.

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Drug mergers

Abandoned at the altar

Apr 29th 2004 | PARIS AND ZURICH
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Having missed out on Aventis, what next for Novartis?

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IT IS rare for Daniel Vasella, the ambitious and inexhaustible boss of Novartis, to lose a fight. So was he really defeated by the mighty French establishment in the recent bidding war for Aventis?

For years, Mr Vasella has been advocating consolidation in the drug industry as loudly as France's nationalists have shouted about the need to maintain a distinguished pharmaceutical tradition dating back to Louis Pasteur. In the end, the nationalists secured their prize, as Aventis agreed to be bought by another French firm, Sanofi-Synthélabo.

The case for marrying Aventis to Novartis was much clearer than that for pairing it with Sanofi. Novartis has superior distribution to doctors in America, the world's most valuable market. Novartis also gets better results than Sanofi or Aventis from its research labs. It boasts that some 25% of its sales come from products less than five years old, including 11 drugs approved by America's Food and Drug Administration (FDA) since January 2000—a bigger percentage than Sanofi. Some 40% of Sanofi's sales are exposed to patent expiration as early as 2006, compared with 17% for Novartis. There would have been lots of potential synergies, including trimming the combined workforce (trickier in an all-French merger). Lower Swiss corporate-tax rates—18% compared with 34% in France—would have saved $100m a year, according to Lehman Brothers.

No wonder that even French business leaders were openly critical of their government's interference. For instance, Ernest Antoine Seillière, boss of the French employers' association, MEDEF, said that in future the government should not express its view of a takeover bid in public.

So, did Mr Vasella, recently declared the “most influential European business leader of the last 25 years” by the *Financial Times*, overestimate his powers? Maybe. On the other hand, he was invited to bid as a “white knight” by Aventis, and, for all his flirtation, he never actually did—though he probably gained valuable market data from Aventis in the process. Meanwhile, Aventis shareholders benefited from his flirtations—Sanofi had to raise its offer.

Mr Vasella's interest in Aventis has prompted some observers to ask where Novartis is now heading. Might his flirting with Aventis, however half-hearted, be evidence that he is finally giving up his dream of buying Roche, a significantly more compelling fit located in his own Basel backyard? Novartis has built up a stake in Roche of close to 33.3%, the level at which it would have to tender to buy the remaining shares. The two firms have extremely complementary pipelines and distribution channels, Novartis doing well with general practitioners, Roche with more specialist doctors.

True, it was never clear precisely how Novartis could acquire Roche, even back in 2001 when Roche was struggling. A company formed by the founding Oeri and Hoffmann families has a controlling stake in Roche, and its shareholder agreement, which precludes selling the stake, does not expire until 2009, a year after Novartis is likely to require Mr Vasella to retire. And although in the drug industry there is probably no share-ownership structure too complicated to unravel for the sake of an acquisition, especially between two Swiss firms, why would the family shareholders support a sale now, when Roche is performing so well?

Having embraced the cause of consolidation, Mr Vasella may end up left on the sidelines. With Aventis tying the knot, and Roche a committed spinster, there is no obvious spouse. More worrying for such a crusader for shareholder value, Novartis shares have languished since 1997—though it is unclear whether

this reflects his failure to merge, or his desire to do so.

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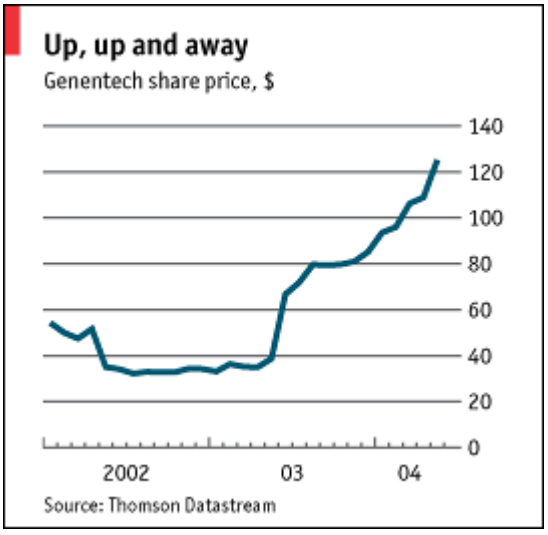
Biotechnology

A rare bird

Apr 29th 2004 | NEW YORK
From The Economist print edition

As most of the drug industry struggles, one firm is flying ever higher

Get article background



NOT everyone thinks that getting big in the drug industry through acquisition is healthy. Some see it as a sign of deep sickness. Healthy drug firms with robust products and full pipelines, they say, stick to the sort of deal-making that is focused on collaborative research and development. To illustrate the point, on the day that Aventis and Sanofi announced their $65 billion marriage to an unenthusiastic stockmarket, another drug company, Genentech, hit a new high on news that its new lung-cancer drug is exceeding expectations.

With rights to several of the hottest new cancer drugs—Herceptin, Rituxan, Avastin and Tarceva—a cash pile of $1.7 billion, and a stockmarket capitalisation of $70 billion, Genentech sees no need to tie the corporate knot. (Roche, a partner in drug development, has long held a majority stake in Genentech—but this is by no means a merger.) Unlike most of its rivals, it has no need of an 11-figure acquisition in order to make its numbers, reinvigorate its pipeline, or churn out successful new products.

Indeed, while many drug firms are struggling to produce new products, Genentech is proof that a firm with the right model and methods can go far. Last year Genentech shares sold for just under $40. They recently exceeded $130, making it the second-most-valuable biotech firm after Amgen, which is worth $75 billion. Analysts forecast that this year Genentech will earn net profits of close to $1 billion, around 50% up on last year, on sales of over $4 billion, around one-third higher than in 2003.

Much of the credit for Genentech's rise is due to its boss, Arthur Levinson. Not so long ago, Mr Levinson was written off by sceptics as “just a scientist”. From the start, Genentech's model has been extremely simple. As Mr Levinson likes to say, “We do cancer, and we try to do it very well.”

In fact, the company's strategy is slightly more complicated than that. What makes Genentech special is not just that it does cancer very well indeed, but that it also delivers on its promises. A perfect example is Mr Levinson's ambitious “5x5” programme. During 1999-2005, he promised, the firm would aim for a 25% average annual increase in pro forma earnings per share; 25% pro forma net income as a percentage of revenues; five new products approved; five products in late-stage clinical trials; and $500m in new revenues from strategic alliances. Genentech is on course to exceed most of these goals. Whether that justifies Genentech's soaring share price remains to be seen—but given the bloated acquisitions elsewhere in the industry, it is easy to understand why investors are so enthusiastic.

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Face value

Chalk, talk and customer service

Apr 29th 2004
From The Economist print edition

Sunny Varkey plans to transform education with his budget private-school business

FEW people praise the state monopoly in education these days, in Britain, America or anywhere else. The main political parties in Britain support choice for parents, and some blurring of the line between state and independent education. Parents have rather more radical desires: a recent poll in Britain showed that 53% would opt out of the state sector if they could afford to, compared with just 7% who go private now. Alas for them, the existing private schools are horribly complacent. Rather than expand into the beckoning low-cost market, they sit in their existing niche, offering expensive education to the lucky few.

This is where Sunny Varkey, a fabulously wealthy Dubai-based entrepreneur, sees an opportunity. His firm, Global Education Management Systems (GEMS), already runs a bunch of schools in the United Arab Emirates, which educate more than 40,000 children. Within five years, he wants GEMS to be running 200 schools in Britain plus a few elsewhere, including in Washington, DC, where he has recently acquired a 30-acre site.

Fees at his British schools will start at just £6,000 ($10,700) a year—only a few hundred pounds more, incidentally, than the taxpayer currently forks out, on average, for a pupil in the state system. This is 25% less than the existing average cost for private education, yet he expects his schools to be not only less-expensive, but better: more focused, more efficient and with superior customer care.

There is room for better results on all those fronts. Most independent schools in Britain (and elsewhere) are poorly managed. They are (nominally) charities, run by a board of governors, often appointed for their personal connections rather than managerial savvy. The headmasters they appoint are often excellent teachers but only rarely good managers of what are, in fact, medium-sized businesses. Reporting lines are blurred. Costs inflate, productivity slides. The mix of goals that the school is trying to achieve—including the charitable purpose, educational quality, size, reputation or efficiency—is muddled.

By contrast, Mr Varkey's schools boast central administration of everything from purchasing to human resources. Overheads will be lower. Training, promotion and recruiting will be more efficient. Moreover, parents will get weekly or fortnightly e-mails giving details of their children's progress, rather than the terse termly reports that most existing independent schools manage. And in what will be a blessing for working parents, GEMS schools will offer breakfast clubs and after-school activities to match the parents'

schedules with their child's.

To cut costs to the bone at the cheaper schools, class sizes may be larger than the norm in Britain; teachers in scarce subjects such as maths and science may be shared between several schools; the curriculum may cover mainstream subjects only.

That is a big leap, admittedly. Most existing schools operate on the principle that, once parents have decided to pay for education, they become quite insensitive to price, and choose only on quality and convenience. But Mr Varkey thinks that education is much like health—another of his businesses. People care about the price of private health insurance—why not of schools?

The strongest selling point for parents considering the budget schools will be good discipline, established chiefly through selection. That again sounds attractive. Dealing with a minority of troubled and disruptive children is one of the state schools' biggest headaches. They are under strong pressure not to expel such children, in order to save costs elsewhere in the system. But the cost of that is then borne by the well-behaved.

So will it work? There are some big questions. Mr Varkey's style and manner are unusual. His private suite at the Dorchester, a famously swanky London hotel, and his exotic suits are a world away from the tweeds and flannels of a typical private-school staff room. Although publicity-shy, his private views on subjects ranging from discipline to obesity and neglectful parents are trenchant. Many parents will like that, particularly in contrast to the agonised political correctness of British education. But to find sites for his schools, and to navigate Britain's restrictive planning rules, GEMS will need to schmooze with local councils, which do not share Mr Varkey's views and which are generally hostile to any competition to state education.

Outsiders think that this hostility will be the biggest obstacle. They note that, after nearly a year, GEMS has added only one school to its original pair in Britain. But the firm has a team headed by a professional property man looking for sites. A senior executive claims that it will have 16 new schools by the end of the year, and expects to be managing another five or six existing independent ones. GEMS has also recruited a lot of impressive educational talent, including Mike Tomlinson, a former chief schools inspector and a well-respected educator, who heads the company's advisory board.

Teaching the state a lesson

All that inspires confidence. But the most interesting question is not whether GEMS manages to open lots of low-cost private schools in Britain, but what happens after that. If a private company can provide an excellent education for the same cost at which the government provides a bad one, it undermines a huge assumption about education all over the world: that public financial support must mean public provision.

That strengthens the argument for the state to distribute education vouchers that parents can use to pay school fees. Parents in Sweden and the Netherlands already benefit from such systems, and they are spreading in America, where six states have some form of voucher. In January, Congress voted through a revolutionary new federally financed voucher scheme for Washington, DC's wretched schools. Mr Varkey's expansion to America could dwarf his impact on Britain.

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Mobile phones

Battling for the palm of your hand

Apr 29th 2004
From The Economist print edition

Just as mobile phones have changed dramatically in recent years, the industry that makes them is being transformed too

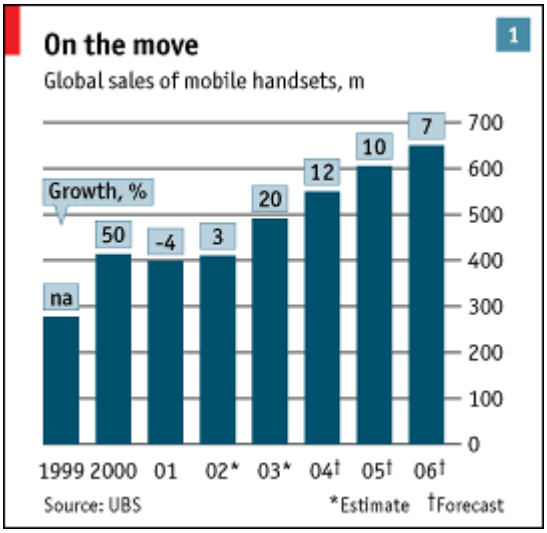
Get article background

NEXT time you pick up your mobile phone, try to imagine how futuristic it would look to someone from ten years ago. Back then, mobile phones were far less sophisticated devices. Brick-like, they had tiny monochrome screens and ungainly protruding aerials, and they were only used for one thing: talking to other people. Today's latest models, in contrast, are elegantly shaped pocket computers. Your current handset may well have a large colour screen and a built-in camera; as well as being a telephone, it can send and receive text messages, and may also serve as an alarm clock, calendar, games console, music player or FM radio.

The mobile phone has become a uniquely personal item: many people take theirs with them even when leaving wallets or keys behind. Some phones designed for business users can send and receive e-mail, and have tiny keyboards; others aimed at outdoor types have built-in torches; still others have satellite-positioning functions, high-resolution cameras with flash and zoom, and even the ability to record and play video clips. Clearly, phones ain't what they used to be.

This spectacular outward transformation of the mobile phone is being reflected by an internal transformation of the industry that makes what have now become the most ubiquitous digital devices on the planet. Over half a billion mobile phones are sold every year, and despite sluggishness in other parts of the technology industry, the number continues to grow (see chart 1). Sales are being driven, in part, by the surge of new subscribers in the developing world, particularly in India and China. In the developed world, meanwhile, where markets are so saturated that most adults already carry a mobile phone, existing subscribers are switching in droves to today's more advanced models. Meanwhile, the number of mobile phones in use, at around 1.4 billion, overtook the number of fixed-line phones last year.

No wonder so many firms now want a piece of the action. The mobile phone sits at the intersection of three fast-moving industries: it is a communications device, computer and, with the addition of new media functions, consumer-electronics product. Indeed, it is the bestselling device in all three categories.



As a result, the firms that have historically dominated the industry—large, specialised firms such as Nokia and Motorola—now face a host of new challengers as well as opportunities. The desire for "ownership" of each mobile-phone subscriber poses another threat to the incumbent handset-makers, as mobile-network operators seek to promote their own brands and to differentiate themselves from their rivals. The result is a little-seen, but almighty, struggle for control of a $70 billion industry: a battle, in short, for the palm of your hand.

Making a mobile phone used to be so difficult that it was the exclusive province of a few specialist companies. It required expertise in an enormous range of areas, from the design of radio chips and software to the integration of electronic components and the styling of the case. Then, since the handsets had to be cranked out in large quantities, there were the problems of running an efficient manufacturing process and complex supply chain, as well as promoting the finished products to a mass consumer market. Furthermore, a company could not just make handsets: to be taken seriously by the mobile-network operators, and ensure everything worked properly, it also had to manufacture the much larger and more complex base-stations that are used to provide mobile-phone coverage.

All of these requirements meant that the industry came to be dominated by large, vertically integrated firms such as Nokia, Motorola and Ericsson. "For many firms good at low-cost electronics, the barrier to entry was simply too high," says Tony Milbourn of TTPCom, a British firm that designs and licenses hardware and software components for mobile phones.

But the situation has changed in the last couple of years. Radio chips can now be bought off the shelf, as can the software required to make a mobile phone work. Manufacturing can be outsourced to an "electronic-manufacturing services" (EMS) firm. Some of these have started to design as well as build handsets; these "original design manufacturers" (ODMs) sell their finished phones to other firms, which in turn sell them under their own brands. Meanwhile, a flourishing ecosystem has sprung up of small firms specialising in areas such as handset design, chip design, testing and software. TTPCom, for example, provides the software that enables Sharp camera-phones and BlackBerry wireless e-mail devices to send and receive data over mobile-phone networks.

In other words, the barriers to entry have fallen. Hardware and software have, to some extent, been commoditised, and there is far more scope for outsourcing of design and manufacturing than there used to be. This has allowed ODMs, consumer-electronics firms and even start-ups to enter the handset business. "Anybody with the right financial backing can break into the phone business now," says Ben Wood, an analyst at Gartner, a consulting firm. The old vertical industry model has been undermined. And it is the rise of the ODMs in particular that is doing the most to disrupt the industry's established order.

Oh Dear Me?

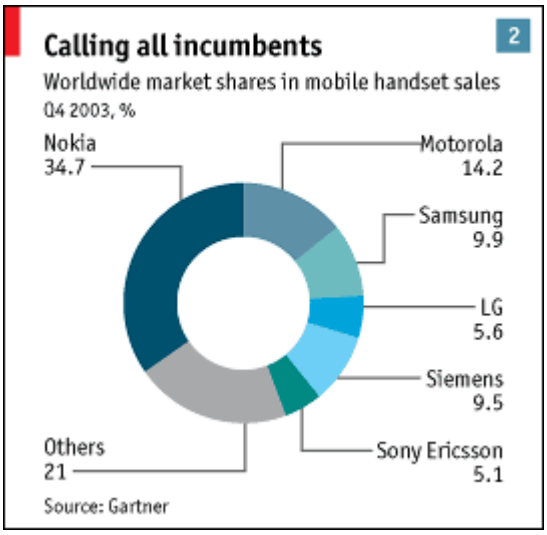
Most ODMs—the biggest are BenQ, Arima and Compal—are based in Taiwan, though there are others in China and South Korea too. All of them design and build handsets for better-known firms, which simply apply their own branding to the finished phones and sell them as their own. The irony is that at the moment the ODMs' biggest customers are the incumbent handset-makers. Arima, for example, makes phones for Sony Ericsson (a handset joint-venture between Sony of Japan and Ericsson of Sweden), while BenQ and Compal make several models for Motorola. Siemens, Toshiba and Panasonic also rely on ODMs to produce some of their phones.

Using an ODM, at least to make some models, has several advantages for the established handset-makers, says Adam Pick of iSuppli, a market-research firm. It lets them fill gaps in their product lines quickly and cheaply; it saves money on research and development; and it means the ODM takes on some of the business risks associated with fluctuations in component supply and end-user demand.

Northstream, a Swedish consultancy, predicts that the proportion of handsets produced by ODMs will grow from 9% in 2002 to around 30% by next year.

But the growing importance of ODMs also poses a long-term threat to the established handset-makers. Motorola, for example, spent a few months polishing an original design from Chi Mei, a Taiwanese ODM, to produce its MPx200 handset, the specifications for which then belonged to Motorola. This approach allows fast time-to-market and means the ODM cannot supply the improved design to rivals.

The risk, notes Mr Wood, is that this process also educates the ODM. By getting too cosy with ODMs, big handset-makers could end up eroding their current technological lead and unwittingly nurturing their own future competitors. Already, some ODMs—BenQ is the most prominent example—are selling handsets under their own brands in some countries. In March BenQ overtook Nokia to become the number two in the Taiwanese handset market.



That is not the only risk. The rise of the ODMs also allows operators to bypass the established handset-makers and produce their own “operator-specific” handsets. This lets them apply their own branding to the handsets and helps them to differentiate themselves from rival operators.

For example, Orange, a European mobile operator owned by France Telecom, sells own-brand smartphones that are built by HTC, yet another Taiwanese ODM, and powered by software from Microsoft. Figures from Orange suggest that these smartphones increase the average revenue per user (ARPU), a crucial industry yardstick, by around €15 ($18) a month. By closely tying a handset with services (in this case mobile e-mail and web browsing), operators can increase revenue and discourage subscribers from defecting to other operators—two key goals.

The success of the Orange handset also showed that operator-specific handsets could deliver results, says John Pollard, director of business strategy at Microsoft's mobile division. “They shipped the thing, and it didn't break,” he says. This has emboldened other operators to follow suit.

Big handset-makers were initially reluctant to modify their handsets for individual operators, since this can reduce their economies of scale and dilute their own brands. But the threat of operator-specific handsets supplied by ODMs has now forced the established suppliers to become more flexible. Motorola, for example, produced a special version of its V500 handset specifically for Vodafone, the world's largest mobile operator, notes Mr Wood. Nokia's reluctance to be flexible—as the leading handset-maker, with the strongest brand, it has the strongest bargaining position with the operators—may have contributed to its unexpected stumble last month. Its share price fell sharply after the company announced that sales had fallen in the first quarter.

Here comes the gorilla

The rise of the ODMs also benefits Microsoft, which had been having great difficulty breaking into the mobile-phone business. Rather than use Microsoft's smartphone software, the established handset-makers set up Symbian, a consortium, to produce an alternative. (They were worried by what happened in the PC industry, where Microsoft established a software monopoly and reduced PC-makers to merely efficient box-shifters with almost identical products.)

But Microsoft got its foot in the door by teaming up with ODMs to produce operator-specific handsets, thus bypassing the established handset-makers. Since then, Motorola and South Korea's Samsung have licensed Microsoft's software for use on some of their phones. Does all this mean the handset industry could end up going the way of the PC industry after all?

It seems unlikely. For one thing, mobile phones are far more personal items than PCs; in effect, they have become fashion items. So far, there is no sign of a Microsoft or Intel-like monopoly in any of the new horizontal layers of the handset industry; the most important standards are open, and exist at the network layer. The power of the mobile-network operators has no parallel in the PC industry; internet-service providers have very little clout. Instead, a better analogy for the mobile-phone industry's new

structure would seem to be carmaking.

Like handset-makers, carmakers used to be entirely vertically integrated. But now there is a complex mix of different approaches. Some carmakers outsource the manufacturing of particular components (engines, for example, or lighting systems); Motorola does the same for the lids of its flip-phones. “For big sub-assemblies, it's very similar to the automotive industry,” says Tom Lynch, president of Motorola's mobile-phone business. “That's the way manufacturing is going.”

Similarly, the design and manufacturing of some cars is outsourced altogether to ODM-like specialists. BMW, for example, got Magna Steyr, an Austrian firm, to design and build its X3 sports-utility vehicle, partly in order to reduce its time-to-market in a competitive sector. But BMW also makes cars in the old-fashioned, vertically integrated way too.

Another parallel between the two industries is the use of “platforms”—underlying common designs that allow components to be shared between outwardly different products. This has the benefit of reducing costs, but it can be taken too far if it results in a bland product line-up. Nokia seems to have run into this problem, as Volkswagen did in the car business.

If the car industry is any guide, then, the likely outcome is that the handset business will shift from vertical integration to a series of horizontal layers: chips, software, manufacturing, design and branding. But unlike in the PC business, no single company will dominate any one layer. Specialists will proliferate; and many firms will choose to compete in more than one layer at once, depending on where their competitive advantage lies. On the spectrum between total vertical integration and total commoditisation, handset-makers hope to end up in the middle, says Vasa Babic of Mercer, a consultancy. They will then be able to reap the benefits of commoditisation, such as lower component prices, without ending up like the PC-makers.

Now what?

The shift away from the old vertical model is causing the incumbent handset-makers to change their strategies in varying degrees. Being able to design your own radio chips is now less important than it used to be; so is owning all of your own manufacturing capacity, or making all your own software. So the incumbents have shifted towards using off-the-shelf chips and software, and to increasing their use of outsourced manufacturing, in the form of both EMS and ODM firms.

Motorola and Sony Ericsson now outsource around 35% of their manufacturing, and neither firm any longer designs its own radio chips. Siemens has taken a similar approach, mixing in-house products with ODM handsets. Nokia, however, insists that its sheer size—its market share is around 35%—means it can still compete in every layer, from chip design to branding. The company relies less on outsourcing than rivals, using it to respond to variations in demand and to benchmark the efficiency of its own manufacturing. Even so, says Olli-Pekka Kallasvuo, head of Nokia's mobile-phones business group, the firm takes a “pragmatic” view and might rely more on outsourced manufacturing in future. Samsung, the world's third-biggest handset-maker, is also sticking with a traditional vertical model.

But will all this be enough to fend off their new competitors? One problem for Nokia and Motorola, says Mr Wood, is that, while they are committed to competing in every market worldwide, their smaller rivals are able to “cherry pick” particular markets and product niches. ODMs already have more than 20% market share in Taiwan, and are now targeting specific markets elsewhere, such as Italy and certain countries in central Europe. This enables them to form relationships with big operators, who in turn can put more pressure on the established handset-makers.

Sendo, a British start-up, is an interesting example. It launched its first handsets in June 2001, and now claims a 5% market share in Britain, and 9% in Portugal, as a result of its willingness to customise phones for particular operators. For Virgin Mobile, for example, Sendo made a phone with a special “V” button. The firm is not an ODM, but concentrates on software, design and customisation, and outsources everything else. It is a new kind of handset-maker that could not have existed just a few years ago.

The growing popularity of outsourced manufacturing is by no means an unstoppable trend, however. Sony Ericsson used to outsource all of its manufacturing, but found its suppliers were unable to meet demand. Katsumi Ihara, the company's president, says about one-third of the company's handsets are now made by Flextronics, an EMS firm based in Singapore. “We are looking for the best mixture,” he says. Similarly, Motorola went too far down the outsourcing route and has since retreated to gain more

control: around 35% of its manufacturing is now outsourced, says Mr Lynch. Northstream predicts that, in the long run, ODMs will account for around half of all handsets manufactured.

Another extreme outcome—the complete disintermediation of handset-makers by operators—also seems highly unlikely. Operators like to have someone to blame when handsets go wrong, and with handsets becoming ever more complex and more reliant on software they are unlikely to want to take on servicing and support. So while some operators will use some own-branded ODM handsets in particular niches, they will not want to do away with traditional handset-makers altogether. “No operator wants to bet its future on sourcing all its handsets from China,” says David Dean, an analyst at Boston Consulting Group.

Instead, the most likely outcome is a compromise in which the established handset-makers' power is reduced by an unspoken alliance between the operators and the new handset-makers. Co-branding, where handsets feature the logos of both operator and handset-maker, looks likely to become the norm. It is already widespread in America and parts of Asia, and is becoming more popular in Europe.

The company with the most to lose is Nokia, which has become so powerful that operators and rival handset-makers are keen to take it down a peg or two. “For Nokia to stay on top of the game it will have to adjust,” says Brian Modoff, an analyst at Deutsche Bank. Unlike Microsoft and Intel in the PC business, Nokia is not protected by ownership of proprietary standards. To maintain margins and stay ahead of the industry's ever-faster product cycle, says Mr Modoff, it will have to stop doing everything itself. “They will be more of a brand, a design shop, rather than building everything,” he says.

Nokia is doing its best to diversify, notably into mobile gaming with its N-Gage handset. At the same time, as handset technology is progressively commoditised, a strong brand will be increasingly important, and nobody has a stronger brand than Nokia. Its recent troubles may turn out to be a blip. But given the seismic shifts now under way in the industry, observes Mr Dean, with Nokia's market share so large “there's only really one way to go.”

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Central European banks

Still getting to know you

Apr 29th 2004 | RIGA AND WARSAW
From The Economist print edition

Western European banks long ago snapped up most of central Europe's banking markets. But there is still plenty to play for

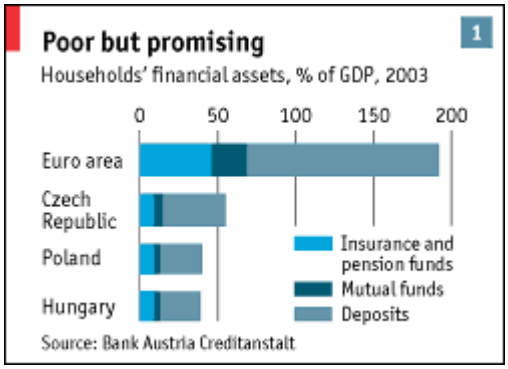
"*IPASI izdevigs risinajums majokla iegadei*" or, freely translated, "the better way for you to buy your home", boasts the website of Unibanka in Latvia, proudly promoting its mortgages in a country where private property, let alone private banking, was illegal a mere 15 years ago. "Pay your bills by internet and win a free flight to Amsterdam", counters a rival, Hansabanka, offering a prize which neatly salutes the main local preoccupation of the moment, the entry of Latvia and seven other central European countries into the European Union this weekend.

The EU comes as an exciting novelty for most people in the region, but bankers there can be forgiven if they look just a touch blasé. Most of them feel as if the EU came for them long ago. Three-quarters of central Europe's banks have been bought by foreign institutions, almost all of which—save, notably, for Citibank and GE Capital—are from other EU countries. Two Swedish banks alone control 60% of the Baltic market, for example: one of them, SEB, owns Unibanka, and the other, Swedbank, owns Hansabanka.

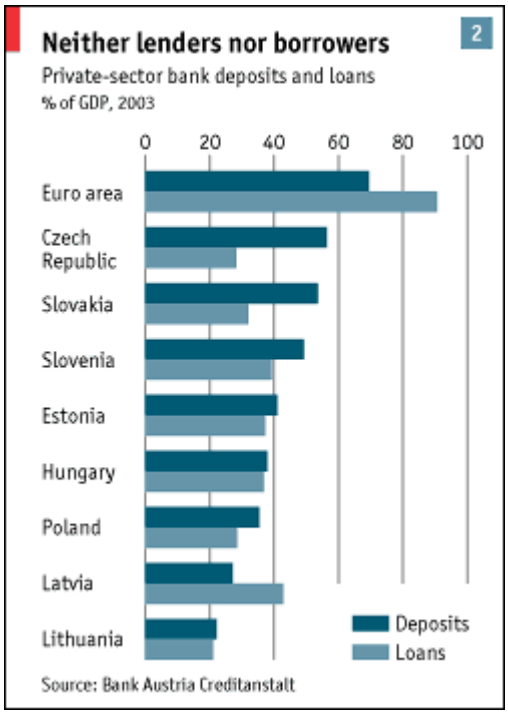
This enthusiasm for central Europe looked risky five years ago, when Russia's default was still rocking the region. Even three years ago there were shivers here and there when growth collapsed temporarily in Poland, central Europe's biggest economy by far. But now the foreigners profess to be much more cheerful. A mortgage boom, sparked by rising wages and falling interest rates, is helping to pump up private lending by 20% a year. Corporate lending should pick up too, helped by recoveries last year in the Polish and Hungarian economies. The share price of OTP, Hungary's biggest bank, has risen by three-quarters in the past 12 months.

The more optimistic bankers are drawing steep upward-sloping lines to show the demand they predict locally for credit cards, mutual funds, life insurance, and all the other posh fee-earning products and services common in the west but great rarities further east (see chart 1). Such hopes are probably well founded—but only for the longer term, at least where the mass of local customers is concerned. Average incomes in central Europe are still only one-quarter of those in western Europe. Most people are poor by EU standards, and even for those with cash to spare, the idea of trusting it to banks is still catching on. According to figures

compiled by Bank Austria Creditanstalt (BA-CA), the average ratio of private-sector bank deposits to GDP in the EU's eight new member countries is just 40%, compared with 70% in the euro zone (see chart 2). The ratios in Bulgaria and Romania, which are next in line to join the union, are a mere 23% and 19% respectively.



Borrowing is less developed still. Bank loans to the private sector amount to 33% of GDP in central Europe, against 91% in the euro-zone. That shortfall betrays a lack of familiarity and expertise, not to say some bad experiences, among central Europe's bankers and customers alike. Whether or not this lack of lending has held back economic growth in the region, it has certainly held back the banking industry. According to BA-CA, the total assets of the 330 commercial banks in the eight new members, Bulgaria, Romania and Croatia amount to about €400 billion, roughly equal to those of one moderately big bank in western Europe.



The problem for the industry has been one of overcoming not only its suppression under communism, but also its messy rebirth afterwards. The new banks started by local entrepreneurs in the early 1990s were often as rackety as the new private companies to which they lent. Inexperienced governments used old state banks to prop up failing factories. Banking crises became rites of passage in which governments learnt that they had to clean up their big banks and sell them to more experienced foreign players if they wanted to have a banking industry at all.

The offer of cheap banks with big market shares mainly attracted western European buyers too small to be global players but still restless in their home markets. KBC of Belgium bought the biggest bank in the Czech Republic, CSOB, and the third-biggest bank in Hungary, K+H. Unicredito of Italy bought the second-biggest bank in Poland, Pekao. Three Austrian banks—Erste Bank, the German-owned BA-CA, and Raiffeisenbank—each bought or built leading banks in the Czech Republic, Hungary and Slovakia, and BA-CA also assembled what is now the third-biggest bank in Poland, BPH. Perhaps the last big prize left for investors is PKO Bank Polski, Poland's largest bank, which is still being groomed for privatisation.

The new EU members have already put in place almost all the changes needed to bring their legal and regulatory environments into line with the union's standards. A challenge still to come this weekend will be the entry into force of the “single passport” system allowing EU banks to open branches in other member countries on the basis of home-country licences alone. That is likely to encourage mainly smaller banks from within central Europe, and from Austria and Germany and Italy, which want to open branches in the border regions of neighbouring countries.

Bigger changes will be forced by the approach of the EU's common currency, which most of the accession countries are likely to adopt towards the end of the decade. Convergence with the euro should mean generally lower interest rates in central Europe, forcing down banks' net interest income. To offset this squeeze, banks will want to make more profits from longer-term loans to business customers, which will mean developing much better risk-management systems, especially for dealing with small business: one big Polish bank admits to a “catastrophic” record here, with fully one-third of its small-business loans hitting problems.

The banks believe they are better at reading the creditworthiness of their retail customers, and they

must hope they are right, given the speed with which they are seeking to add business. Bank Pekao, for example, lists among its “product priorities” for this year a “push” on mortgages and a “massive” campaign to promote credit cards to its customers. Other Polish banks have been offering low-interest mortgage loans denominated in euros and Swiss francs—which looked cheap, but have proved to be unexpectedly expensive for borrowers as the zloty has slid by 15% against the euro since the start of last year.

But by and large, the foreign banks are winning their bet. Their central European operations, if properly run, look poised for a series of fat years in which they combine emerging-market growth rates with EU levels of comfort and security. That is very nice for most bankers, but a touch boring for some. The first movers have already done their shopping in Romania and Bulgaria, and are now busy bargain-hunting in the western Balkans.

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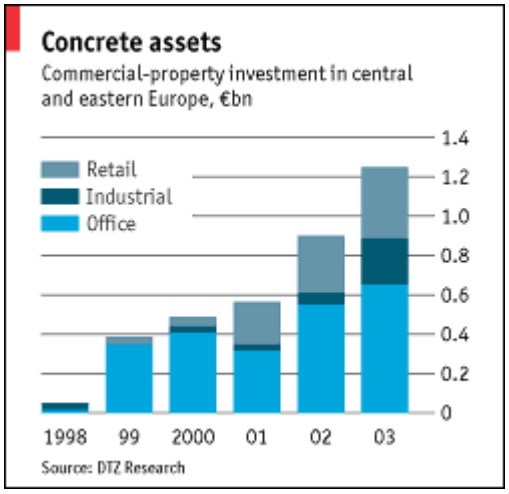
Central European property

Urban spacemen

Apr 29th 2004 | WARSAW
From The Economist print edition

A boom in the European Union's new member states



EREZ BONIEL has a spring in his step. Mr Boniel is a board member of GTC, a Polish commercial-property developer with a half-share in Galeria Mokotow, a thriving shopping mall in an affluent district of Warsaw. On May 6th, Globe is due to make its stockmarket debut. The timing, says Mr Boniel, is impeccable. The flotation will happen just a few days after Poland and seven other post-communist countries join the European Union. Western investors, particularly Austrian and American funds, are piling into central Europe.

After a decade or so of frenzied development, the region's once-dowdy urban landscapes have changed beyond recognition. Budapest, Prague and Warsaw all experienced a boom in the supply of modern office space as multinational companies moved in. “There wasn't a single decent communist-era [office] building,” recalls Chris Bennett, head of the central European operations of DTZ, a property consultancy. The notoriously inflated prime rents of the mid-1990s, which reached $60 per square metre in downtown Warsaw, have since tumbled as supply has outstripped demand. Yields have fallen too—although at 8-9% they remain higher than in western Europe.

According to a report by DTZ, $4.3 billion poured into central European commercial property between 1998 and 2003, and two-thirds of that went into office buildings. Now retail space is all the rage (see chart). Rising incomes and alluring demographics—33% of Poles are less than 25 years old—are driving investment in trendy shopping malls centred on giant, foreign-owned hypermarkets. In March, Apollo, an American private-equity firm, and Rida Development, a Polish-American company, acquired a portfolio of Polish shopping centres for $860m in one of the largest property deals yet in central Europe. Rodamco, Europe's largest retail-focused property group, owns half of Zlote Tarasy, a 225,000-square-metre office, retail and entertainment complex in the heart of Warsaw that is due to open next year.

The investment is now spreading to provincial cities. Despite their keenness, investors have plenty of concerns. Central Europe's property market is hobbled by a lack of top-quality buildings and by unclear or extremely dispersed ownership rights: outstanding claims for restitution by pre-communist owners have been a perennial irritant for developers. And there is a glut of new offices, particularly in Budapest, which now has one of the highest vacancy rates in Europe. That is a common hazard in property markets everywhere.

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America and the WTO

A knotty problem

Apr 29th 2004 | WASHINGTON, DC
From The Economist print edition

The WTO looks set to declare America's cotton subsidies illegal

AMERICA'S subsidies to its cotton farmers have long been an egregious example of the harm that rich countries' subsidies inflict on the poor. While Uncle Sam shovels $3 billion a year to 25,000, mainly rich, American cotton farmers, their overproduction pushes down the world market price, impoverishing the millions in poor countries who rely on cotton for their livelihood. This week the World Trade Organisation (WTO) took a step towards ending this outrageous practice.

On April 26th, the WTO issued an interim ruling that appeared to declare these subsidies illegal under global trade rules, by siding with Brazil in a complaint against America. Only appeared? Well, the case is complicated; and the interim ruling has been made public by neither Brazil nor the United States. But an American trade official expressed “serious concerns” and promised to appeal against the final ruling if it remained unchanged, while the Brazilians announced they were satisfied. So the ruling's broad thrust is not hard to infer.

In September 2002, Brazil complained formally to the WTO about America's cotton subsidies. The Brazilians argued that these violated the “peace clause” on agricultural subsidies that was negotiated under the Uruguay round a decade ago. According to this clause, countries promised not to file complaints to the WTO on farm support—provided that subsidies did not exceed their 1992 levels. The Brazilians claimed that America's cotton subsidies were higher than the agreement allowed and that they harmed Brazilian producers by lowering prices in world markets. Without subsidies, they argued, American exports would have been lower and world cotton prices higher.

Legally, the ruling clearly cuts new ground. The WTO's final decision will be its first on farm subsidies. But it is unclear exactly what sort of a precedent it might set. Although all rich countries throw money at their mollycoddled farmers, the technical details of support systems vary enormously. Just because some aspects of America's cotton programme are against WTO rules, it does not mean that others are. Still less does it follow that other countries' farm-support regimes would be on the wrong side of WTO law. Nonetheless, as Gary Hufbauer of the Institute for International Economics points out, the WTO decision could open the door for all kinds of litigation.

The decision will have political ramifications too. At the international level, the dynamics of the stalled Doha round negotiations on agriculture may well change. The trade talks faltered in Cancún last year in large part over rich countries' unwillingness to give more ground on farm trade. Cotton was a particularly emotional issue, as a group of poor African countries tried to push for an elimination of subsidies for the crop, and were roundly rebuffed by America. If poor countries now have WTO jurisprudence on their side, pressure may mount on rich countries to offer more generous cuts in subsidies.

Then there is the question of how the decision will play in America itself. Washington lawmakers may become even more sceptical of the WTO than they already are. Farm-belt politicians have decried the ruling. The head of America's corn growers' association called the WTO's decision “detrimental” to all the country's farmers. Even the White House weighed in: President Bush's press secretary claimed that America's farm programmes were fully WTO-compatible. He reassured farmers that there would be no immediate impact on their subsidies and that America had “no intention of unilaterally taking steps to disarm”. But the WTO may require it to do just that—or face sanctions.

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Insurance

Going for brokers

Apr 29th 2004 | NEW YORK
From The Economist print edition

Now America's insurance industry comes under regulatory fire

AP

He's back

HAVING forced investment banks and mutual funds into legal settlements, New York state's attorney-general, Eliot Spitzer, has selected his next opponent: the insurance industry. Since April 23rd more than a dozen of America's largest insurance brokers have received subpoenas demanding information on compensation arrangements with insurance companies. As with Mr Spitzer's other investigations, the focus is conflicts of interest: did payments made by insurers to brokers for putting business their way compromise brokers' duty to their clients?

There is little public information about what proportion of brokers' revenues come from such kickbacks. Estimates vary from 5% to 20%. They have been used more often in recent years as brokers have evolved from merely connecting companies with underwriters to doing things that insurers used to do themselves: assessing clients' needs and structuring complicated bids. Having taken on some of the insurers' functions, the brokers seem to have believed that they deserved some of their premiums too.

At first glance, the case looks to be right up Mr Spitzer's street. The target is a powerful industry; and because states regulate insurers, there is little chance that federal authorities will interfere. That said, how keen will the attorney-general be to persevere? The victims this time are not small investors (ie, voters) but rather companies; the headlines are likely to be smaller. Equally important, the insurance industry is not averse to defending itself in court. Might that put Mr Spitzer off?

The insurance brokers are taking no chances. The biggest of them have all said, accurately, that they disclose the receipt of compensation directly from insurers. Even so, the disclosure usually contains few details to illustrate when it is in a broker's interest to place a policy with one insurer rather than another. Even experienced industry analysts say they have no firm idea of how these compensation arrangements actually work.

Daniel Popeo, chairman of the Washington Legal Foundation (WLF), a think-tank which in February first brought the issue to regulators' attention, has cited two conflicts: contingency fees paid to brokers according to the volume and profitability of business placed with an insurer; and demands that insurers provide reinsurance work to brokers in exchange for referrals. A contingency fee, for example, might entice a broker close to meeting an insurer's volume target to place his next client's policy there, even if another insurance company has a better or more keenly priced product.

Aon, Marsh & McLennan and Willis, the three biggest brokers, acknowledged receiving subpoenas from Mr Spitzer and declined to comment further. Aon's shares took the biggest hit, dropping 8%; but according to *Insider Week*, an industry newsletter, Marsh, by far the largest broker, has been the most adept at capturing commissions from insurers. And this investigation comes as its mutual-fund operation, Putnam, tries to dig itself out of scandal. If the investigation heats up, Aon and Marsh may see parts of their business models, which include direct investment in insurance companies and pension consulting, come under review. In the past, brokers have defended themselves against accusations of conflicts by saying that their clients would leave if they did not do a good job. This is a reasonable argument; but banks and fund companies said the same, and were not spared.

One question doing the rounds is: what prompted Mr Spitzer to act? Despite the WLF's promptings, it

seems that the issue gained urgency only when a whistleblower, familiar with industry practices, came forward. But who? An obvious candidate would be a firm irked at having to deal with a small number of brokers whose objectivity was in question. Another delicious rumour is that the sneak was an underwriter hoping to cut commissions to brokers but worried that doing so unilaterally would cost business. Using Mr Spitzer to reduce expenses would be a novel strategy but, given the times, may turn out to be a winning idea.

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Spanish banks

Fun and games

Apr 29th 2004 | LONDON AND MADRID
From The Economist print edition

Another day, another executive on trial

IN THE spirit of the times, another boss finds himself heading for court. On April 27th, a judge in Spain ordered that Emilio Botín, head of one of the country's most powerful families and chairman of Santander Central Hispano, its biggest bank, be tried for misappropriation of funds.

Mr Botín is accused of harming shareholders by bestowing severance packages totalling €164m ($145m) on two former bosses of Santander Central Hispano, José María Amusátegui and Ángel Corcóstegui, who are due to stand trial with him. The payments ended a bitter power struggle following the 1999 merger of Santander, run by Mr Botín, and Banco Central Hispano Americano, of which Messrs Amusátegui and Corcóstegui were bosses. The duo's departures (and fat paydays) cleared the way for Mr Botín to consolidate control of the newly merged bank.

By European standards, the severance packages are exceedingly big—dwarfing the contested €57m in bonuses at the heart of the trial in Germany of board members of Mannesmann, a telecoms company bought by Britain's Vodafone in 2000. Whether the payments were illegal is another matter. Two months ago, the then head magistrate of Spain's High Court, Jesús Cardenal, recommended to the prosecuting judge that the case be dismissed.

Spain's stockmarket regulators believe they have nothing to fret about. The Bank of Spain has found nothing illegal in the payments. The markets are unperturbed: Santander's share price has barely budged. Many in Spain's cosy banking world doubt a full trial will ever take place, and not only because Mr Botín is an influential man. He did not act alone: Santander's board unanimously agreed to the payments and the bank's bylaws allow for them.

As important, it is difficult to argue that Mr Botín has hurt shareholders. In 1986, when Mr Botín took the reins from his father, Santander was just one of Spain's seven leading banks. Now, after a string of acquisitions and investments at home and in Latin America, it is number 15 in the world by market capitalisation. Profits have ballooned to €2.6 billion in 2003, from the equivalent of €133m when Mr Botín first took over; assets have grown to €349 billion. “The bank's transformation is due, in great part, to Botín's leadership and vision and stamina,” says Davide Serra of Morgan Stanley.

Along the way Mr Botín has made enemies as well as friends. Some Spanish bankers think the lawsuit is partly personal. It is one of 26 suits against Mr Botín or his bank in which Juan Francisco Franco, a shareholder, and Rafael Pérez Escolar, an erstwhile executive of Banco Español de Crédito (Banesto), which was bailed out by the Bank of Spain in 1993 and bought by Santander in 1994, have had a hand. Mr Escolar went to prison for his part in Banesto's implosion.

Seven of the 26 lawsuits have been dismissed without charges and the rest are in legal limbo.Whether this action will meet with more success is still an open question. But it is unlikely to be the last launched by shareholders disgruntled by the scale of executive pay.

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Banking in South-East Asia

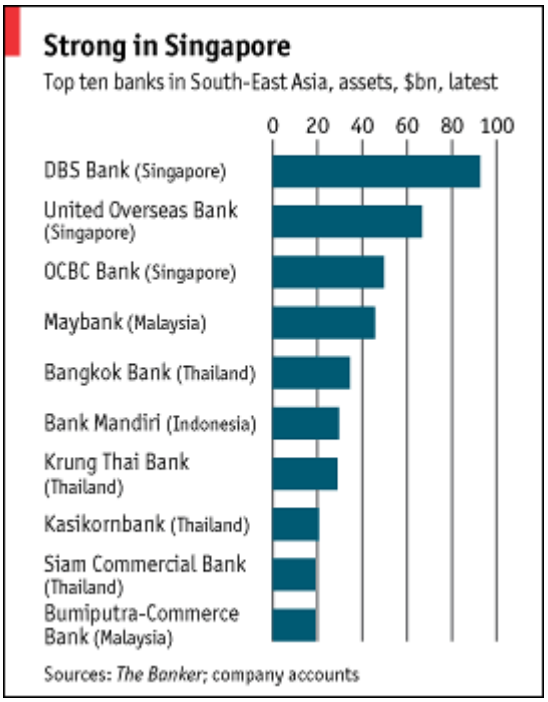
Recuperating

Apr 29th 2004 | BANGKOK
From The Economist print edition

A blighted industry returns to health

SOUTH-EAST ASIA'S more upbeat bankers will tell you that they have finally put the meltdown of 1997 behind them. Lending is growing again; profits are back; and capital is more than adequate. Endless gloomy analysis of non-performing loans has given way to giddy speculation about takeovers: this week Singapore's United Overseas Bank (UOB) looked set to buy most of Bank of Asia, Thailand's ninth-biggest bank. Pessimists point out that governments still meddle, legal systems are not yet up to scratch and balance sheets are not quite what they seem. In one sense, however, the debate is moot: whatever their strengths and weaknesses, banks matter much less to the economies of South-East Asia than they once did.

For the time being, optimism prevails, thanks in large part to renewed economic growth. Non-performing loans in Indonesia have fallen from 50% of the total in 1998 to just 5% today. They are below 15% in Thailand, Malaysia and the Philippines. The ratio has been cut partly by restructuring and partly by loan growth, which reached 5% or more last year in most of the region's largest economies.



But South-East Asia's bankers have not been just twiddling their thumbs, waiting for an upturn. Like bankers elsewhere, they have tried to instil better risk management and have reduced their dependence on corporate lending by pushing consumer finance, using all sorts of new products and marketing techniques. In Malaysia, mortgages, consumer credit and loans to small businesses now make up about half of all lending, up from a third before the crash. Some in Malaysia and Indonesia are pushing Islamic banking. In Thailand, Kasikornbank is opening branches with coffee shops, while the state-owned Government Savings Bank is experimenting with 24-hour service.

Regulators, too, have smartened up their act. Since the crash, most have tightened their definition of non-performing loans and raised capital-adequacy requirements. Indonesia, Malaysia and Thailand are all reforming their deposit-insurance schemes. Regulators have also forced banks to consolidate: Singapore now has only three commercial banks and Malaysia has ten. Thailand has introduced new licensing requirements aimed at reducing its count from 13 to three or four.

Most heartening of all, governments are beginning to sell the banks they took over during the crash, leaving less scope for political interference. All this has prompted a wave of cross-border takeovers, as Singaporean banks, long South-East Asia's strongest, snap up stakes in their weaker counterparts. UOB already owns most of Radanasin, a Thai bank, and is acquiring 23% of Indonesia's Bank Buana. Its rivals, OCBC Bank and DBS Bank, own or hold stakes in Thai, Malaysian, Philippine and Indonesian banks, and want to buy more.

However, the region's banks are not yet as healthy as all this might imply. For starters, the reduction in non-performing loans is deceptive. Some 35% of current Thai loans were once classed as bad and many have been only superficially restructured. Nor does loan growth in Thailand bear much scrutiny. Two state-owned banks, Krung Thai and Siam City, account for over half the new lending. Under instructions

from the government to jolly the economy along, they are piling into volatile assets such as property even as their private-sector rivals try to cut their exposure. One private-sector banker recounts how some of his most hopeless customers had no trouble refinancing their loans at state banks.

Such blithe handouts demonstrate the risks of state ownership. Despite recent sales, over half of Indonesia's banking system and a third of Thailand's remain in government ownership, as do stakes in big banks in Singapore and Malaysia.

Nor has stricter regulation cut out hanky-panky. Indonesia has suffered two banking scandals in the past year. Much of the $60 billion the Indonesian government spent bailing out banks disappeared without trace, yet only a handful of bankers have been prosecuted. Across the region, creditors still have trouble enforcing their rights: legal struggles over big debtors such as Thai Petrochemical Industry and Asia Pulp & Paper continue.

At least such deficiencies matter less than they used to, since banks are no longer the only source of financing for South-East Asian businesses. Last year Thai companies raised almost as much from share and bond issues as they did from bank loans. Throughout the region, according to Noritaka Akamatsu of the World Bank, banks' share in the financial sector is decreasing. That, most observers agree, is unambiguously good news.

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Investing in Indonesia

At a crossroads

Apr 29th 2004 | JAKARTA
From The Economist print edition

Indonesia's judiciary unnerves foreign investors—again

ONCE more Indonesia's notoriously corrupt courts have struck a blow to the government's efforts to woo foreign investors. In a reprise of its 2002 verdict against Manulife, a Canadian insurer, Jakarta's commercial court has declared bankrupt Prudential Life Assurance (PLA), the local unit of Prudential, Manulife's British rival, even though no one denies that the firm is solvent.

The judges ignored PLA's rude health and invoked a bizarre article in the bankruptcy law that allows a company to be declared bankrupt regardless of its financial condition if it refuses to settle its debts. The company is alleged to owe 365.8 billion rupiah ($42.4m) to a Malaysian agent, Lee Boon Siong, mainly for claimed loss of future earnings. Mr Lee says that his contract was ended nine years prematurely without good reason.

PLA has suspended its operations and is hurriedly filing an appeal with the supreme court. The company describes the suit as baseless, but refuses to discuss it in detail. Whatever the merits of Mr Lee's claim and of allegations of judicial graft, the wider considerations bode ill both for Prudential and for Indonesia's stuttering economic recovery.

If the court-appointed administrator is able to secure access to the company's assets, many millions of dollars of policyholders' money could be at risk. PLA claims that last year alone its premiums from new policies topped 1 trillion rupiah ($11.6m).

On the national level, the continuing legal uncertainty and accompanying endemic corruption are driving investors away in droves: Indonesia is the only country in the region recording negative foreign direct investment. The speed with which Indonesian government ministers and legislators rallied to support Prudential demonstrates their desperation to resolve what is unquestionably a deep embarrassment for them. But they have only themselves to blame.

In the wake of the Manulife saga an amendment was proposed to the existing laws to transfer the power to declare companies bankrupt from the courts to the financial regulators. This legislation is, however, still buried in the ministry responsible for drafting legislation and there are few signs of its being unearthed soon. Even if it were, parliament's sloth has resulted in such a backlog of work that legislators are unlikely to find time for the amendment in the next six months.

Ironically, the Prudential affair has erupted just as Jakarta's stock exchange is hitting new highs almost daily and when government bonds are several times oversubscribed. Interest in making money in Indonesia thus clearly exists, but mainly in ways that avoid the courts and come with a simple exit strategy.

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Economics focus

Degrees of difference

Apr 29th 2004
From The Economist print edition

In the third of a series of articles on the Copenhagen Consensus project*, we look at climate change

Get article background

GLOBAL warming looms, in many people's minds, as one of the biggest threats facing the planet. Over the past 20 years researchers have gathered evidence that the burning of fossil fuels is causing temperatures to rise. However, the exact pace of global warming, as well as the size of mankind's contribution to the warming trend, remain uncertain. Aside from these issues is the question of precisely how greenhouse-gas emissions should be abated, assuming that they need to be reduced at all. In a new paper for the Copenhagen Consensus project, William Cline of the Centre for Global Development and the Institute for International Economics examines these topics.

Rising temperatures are capable of causing great economic harm—though a lot depends not just on how big future rises prove to be but also on how quickly they happen. One estimate is that a doubling of atmospheric concentrations of carbon dioxide would cost between 1% and 2.5% of global GDP, depending on what kinds of damage you include.

One study from America's Environmental Protection Agency listed the possible costs. Around a quarter of the total economic damage would fall on farmers, who could no longer use some lands. Around a sixth of the total cost would come in the form of increased cooling costs for homes and offices (net of the reduced costs of heating). Rising sea levels, damage to drinking-water supplies and heatwaves would each account for 10%. Deforestation and rising ozone pollution together would add another 10%. And the economic estimates exclude the “amenity value”—the price people would be willing to pay to avoid rising temperatures for reasons of convenience.

Yet totting up such figures is far from straightforward. That is because applying cost-benefit analysis to climate change is harder than for most public-policy questions: many of the benefits will not be realised for decades or centuries, while the costs of abatement will be felt today.

Using a discount rate of, say, 3-6%, which would be typical for most short-term projects, would cause you nearly to ignore any costs and benefits occurring in 100 years' time. Mr Cline uses a discount rate of just 1.5%, which has the effect of making the future benefits of slowing global warming much more attractive than they would be under traditional analysis. So he can certainly not be accused of minimising the pain of global warming for future generations, nor of hyping the economic costs of abatement in the near future. On the other hand, the rationale for the use of a much lower rate is unclear. To say that without using such a rate, abatement would be minimal is not a very persuasive reason. That way of thinking fails to demonstrate that strong abatement is necessary; in effect, it merely assumes it to be necessary. Be that as it may, using such discounting and a widely cited model developed by William Nordhaus of Yale University, Mr Cline then considers three possible remedies.

Kyoto revisited

One is the Kyoto treaty. The goal of that agreement was to freeze rich countries' carbon emissions at 5% below their 1990 levels, while letting poor countries emit as much carbon as they please. According to Mr Cline, slowing global warming in this way would yield benefits totalling $166 trillion (in 1990 prices, as are all of the following figures). The costs of abatement amount to $94 trillion, giving a global benefit-to-cost ratio of 1.77. But the costs and benefits are unequally shared in the Kyoto approach. Industrial

countries must cut back heavily on carbon emissions and realise comparatively few benefits: for them, the benefit-to-cost ratio is far less than one. That helps explain, argues Mr Cline, why many rich countries refuse to sign the Kyoto treaty.

Mr Cline next considers a global carbon tax. This ought to be more efficient than the Kyoto caps, since it would encourage the lowest-cost reductions in carbon emissions to happen first. The discounted costs of applying such taxes would amount to $128 trillion up to 2300. The benefits are reckoned to be $271 trillion. That produces a benefit-to-cost ratio of 2.1. Carbon taxes do indeed give better value for money than Kyoto.

The last policy recognises that predictions of climate change encompass a wide range of scenarios. Mr Cline looks at the costs and benefits of abating global warming in 95% of possible outcomes, rather than focusing only on the median prediction for climate change. This strategy is even more aggressive than the other two, as it addresses worst-case scenarios. Reducing emissions by enough to mitigate damage in 95% of scenarios would be extraordinarily expensive—a cost of 3.5% of world economic output for the rest of the 21st century, rising to 5% later: $458 trillion in net-present-value terms. But the gains, if measured against the worst-case scenarios, are big too: some $1,749 trillion. The benefit-to-cost ratio would be 3.8.

All of these figures are huge and, given the time horizon, very speculative. Mr Cline emphasises that much depends on how you discount costs and benefits for future generations. Even on his analysis, with many assumptions very favourable to aggressive abatement strategies, the economic benefits of reducing global warming are not felt in any of the three policy regimes until around 2100—and the costs are felt immediately. Policies to deal with global warming do not produce the short-term gains of many other development policies.

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* The Copenhagen Consensus project, organised by Denmark's Environmental Assessment Institute with the co-operation of *The Economist*, aims to consider, and to establish priorities among, a series of proposals for advancing global welfare. The initiative was described in our Economics focus of March 6th. That article can be read here, along with other material, including an Economics Focus on corruption, published this week online only. A book, "Global Crises, Global Solutions", containing the full set of papers written for the project is forthcoming from Cambridge University Press.

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Biotechnology

Sea of dreams

Apr 29th 2004 | ORLANDO
From The Economist print edition

Photo courtesy Bermuda Biological Station for Research/Paul Lethaby

Genetically modified microbes will lead to a revolution in industrial biotechnology

CRAIG VENTER, the man who led the privately funded project to sequence the human genome, is someone who likes to mix business with pleasure. And for a geneticist whose passion is sailing, there can be few more satisfying ways of doing so than sampling genes in the Sargasso sea, near Bermuda. The samples he took there last year yielded a surprise. The sea had looked as though it was the oceanic equivalent of a desert, bereft of nutrients, and with little life beyond the *Sargassum* weed that gives the sea its name. But when Dr Venter ran his samples through his newly developed method for sequencing the DNA of an entire environment, some 1.2m new genes turned up from an estimated 1,800 species of microbe previously unknown to science. An apparently empty sea was teaming with bacterial life.

Such newly discovered genes are the raw material for the infant, but rapidly developing field that makes useful chemicals via genetically modified organisms. It is part of what is known as industrial biotechnology, where cells from animals, plants and bacteria are used to generate industrially useful products. The Sargasso results, outlined last week to the World Congress on Industrial Biotechnology and Bioprocessing, in Orlando, Florida, by Dr Venter's colleague Karin Remington, suggest there are a lot of useful raw materials to be found.

Dr Venter's Institute for Biological Energy Alternatives, based in Rockville, Maryland, is now taking further samples from around the world. Although Dr Venter is turning such bioprospecting from a sport using a fishing line to one using a trawling net, looking for new bacteria is already a well-established activity. The business models of firms such as Diversa, a company based in San Diego, are centred on it.

Blowing hot and cold

Diversa is prospecting in hot springs, ocean beds, soda lakes and on the Arctic tundra. The genes it, and others, are looking for are instructions for producing proteins—many of which are natural catalysts inside living cells. By searching in wild and wonderful environments, microbiologists hope to find new genes that might be of use to investors and customers.

Many people now hope that this year's Orlando congress will become an annual event. They see industrial biotechnology as the wave of the future—a phenomenon that will eventually rock entire economies. Whether this is the case or not, in the shorter term it does seem likely that industrial biotechnology will shake up the chemical industry. And it may provide a route to a future less dependent

on fossil fuels, and one that puts less climate-changing carbon dioxide into the atmosphere.

Finding a gene, though, is only the first step towards a product of commercial interest. Philippe Soucaille, chief scientific officer of a company called Metabolic Explorer, based in Clermont-Ferrand, France, told the meeting that his firm is working with a database of all the biochemical pathways it can get its hands on and a computer model of the metabolism of a bacterium called *Escherichia coli*. This is the most popular organism for bacterial geneticists to experiment upon, their equivalent to a laboratory rat.

Given a starting material and an end-product, Metabolic Explorer's system will assemble the best set of pathways and then work out how to fit them into *E. coli*, and say which existing *E. coli* pathways should be deleted. It will also identify potential biochemical bottlenecks where enzymes might need modifying to speed things up. Thus the company can pick-and-mix biochemical pathways from different organisms and put them together in a single bacterium, as a computer programmer might assemble a piece of software from pre-written sub-routines.

Once the pathways have been selected, and the new enzymes designed, it is just a question of adding the relevant genes to *E. coli*, removing the genes for the undesired pathways, and seeing whether the result lives up to expectations. Metabolic Explorer has already done such work under contract for several other firms. Currently it is using the process for its own benefit, to produce methionine, an amino-acid animal-feed supplement with a market worth $1.4 billion a year. Bio-Technical Resources, of Manitowoc, Wisconsin, has used a similar technique to produce glucosamine, an amino-acid supplement favoured by many people with arthritis.

Such sums, of course, are peanuts compared with the money to be made outside the niche end of the chemicals market. But they represent a bonanza to small biotechnology firms. And industrial biotechnology looks set to make further inroads into the market for boutique chemicals. Many other products have fallen, or look ready to fall, to biotechnological processes that are cheaper than traditional chemistry, have higher yields or produce a cleaner product. These include other amino-acid supplements, vitamin supplements, antibiotics, anti-influenza drugs, foundation creams for cosmetics and even the solid rocket-fuel that is used in air-to-air missiles. According to Jens Riese, of McKinsey, a consultancy, about 5% by value of the world's chemical output is already biotech-based and this is expected to rise to 10% over the next six years.

All this progress is largely invisible to the public. Indeed, given the consternation about public reactions to agricultural biotech, there were some misgivings among delegates as to what would happen when the public realised what was going on. If the next phase of industrial biotechnology works, the field's profile will grow considerably more visible. The really serious money is to be made in bulk chemicals and fuels.

Fantastic plastic

Genetic engineering can already deliver many traditional chemical-feedstock molecules. Metabolic Explorer, for example, can turn glucose into acrylate, a feedstock for the plastics industry. Cargill, a large agricultural company that has been interested in biotechnology for some time, is turning its attention to a glucose-derived substance called 3-hydroxypropionic acid. This can be made with modified microbes. Further microbes can then produce a dozen chemicals that are precursors for plastics. John Frost of Michigan State University (and the inventor of biotech rocket-fuel) has even worked out how to use bacterial enzymes to make a form of Nylon. It all sounds promising. But what biotechnology mostly cannot do yet is produce either feedstock or finished product more cheaply than the petrochemical industry.

There are a few well-trumpeted exceptions. Cargill-Dow, a joint-venture between Cargill and Dow Chemicals, produces a cost-effective polymer made from lactic acid that has, in turn, been made from maize-derived glucose. Metabolix, a small firm based in Cambridge, Massachusetts, has a suite of plastics called polyhydroxyalkanoates, which are grown inside genetically engineered bacteria and that the firm seems confident will be cost-competitive with at least some existing specialist plastics. And DuPont, another big chemical company, has Sorona, a plastic that is half biotech and half traditional. But the breakthrough everybody is waiting for is a way of producing glucose really cheaply. For glucose is to industrial biotech what crude oil is to petrochemicals.

Once again, microbes are the key. The main source of industrial glucose in North America is maize starch, which is relatively costly. But most of the dry weight of a plant is composed of cellulose. Cellulose, like starch, is a polymer of glucose. Unlike starch, though, it is tough. But if it could be used to

make glucose, much agricultural waste, such as straw and the leftovers from maize farming, could be turned to account. It can be broken down biologically, and the enzymes to do such a job are found in many bacteria and fungi. The search is now on for the best enzymes and ways of upgrading these into industrial products.

Some significant progress has already been made. Novozymes is a Danish company with a research laboratory in Davis, California that is devoted to the question. And as Sarah Teter, one of the people in charge of the project, explained, the firm is working on a mixture of fungal enzymes that collaborate by attacking different parts of the cellulose chain.

Novozyme's target chemical is actually ethanol. This is fermented from glucose, and can be used as a substitute for petrol. The firm has improved the process of fermenting cellulose into glucose, and then glucose into ethanol, in ways that have reduced the cost ten-fold.

This still means that the enzyme processing for an American gallon of cellulose-derived ethanol costs 50 cents. But Novozyme hopes to bring that cost down another ten-fold over the next few years, to a point where ethanol derived from cellulose might be cost-competitive with petrol. And if ethanol can be made cheaply from cellulose, then so can a lot of other bulk chemicals. One idea is to use special chips known as DNA microarrays, which show what genes are active at a given moment, to work out what other enzymes the fungi are making when they digest cellulose. Chucking those enzymes into the mixture should make a significant difference.

In an announcement whose timing was probably not coincidental, a Canadian company called Iogen proudly proclaimed at the meeting that its cellulose-ethanol plant in Ottawa—the first such commercial venture in the world—had just opened for business. That plant is, in part, the product of subsidies, so its true relevance remains to be seen. But it is, as it were, a straw in the wind.

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Computing

First base

Apr 29th 2004
From The Economist print edition

A biological computer diagnoses and treats cancer

COMPUTERS may come in all shapes and sizes these days, but on the frontiers of research they are becoming more esoteric than is easy to imagine. In 1999, Ehud Shapiro, a researcher at the Weizmann Institute in Israel, suggested a design for a computer built out of nothing more than carefully engineered biological molecules. Two years later Mr Shapiro, together with a team of other scientists from the Weizmann Institute, built it. It was made of DNA.

The computer was so small that a trillion could exist, and compute in parallel, inside a small drop of water. The hardware of the computer consisted of enzymes that manipulate DNA, the software was the DNA itself. The result was an output molecule. Now, Dr Shapiro and his colleagues at the Weizmann have taken their research one step further by showing how such work might be useful. This week they claim, in an online paper in the journal *Nature*, that they have programmed a biological computer to diagnose and treat cancer.

To understand this remarkable feat, a little bit of background is necessary. What the team have built is known as a Turing machine, a notional type of computer first proposed in 1936 by Alan Turing. This British mathematician imagined a general-purpose computer that worked by manipulating a paper tape divided into cells. Each cell was either blank or contained a symbol; the machine would move up and down the tape looking at the contents of the cells, checking its own internal state, and then applying a set of rules to this information to decide what to do next. Substitute a molecule for the paper tape, and this design can be adapted to build a biological computer.

Certain diseases, such as cancers, will induce biochemical changes in the body such as changes in the balance of molecules that it produces. Dr Shapiro's computer diagnoses an imbalance that indicates the presence of prostate cancer. After diagnosis it releases short strands of DNA designed to kill these cancer cells. The computer works by analysing levels of a molecule called messenger RNA (mRNA). This is a chemical cousin of DNA that transfers genetic information—in this case for disease-related genes—from the cell's nucleus to the rest of the cell. It is here where the business of using this genetic information to direct living processes is carried out. And after the computer has measured levels of mRNA, the output molecule of the computation is able to affect the levels of expression of the diseased genes.

Dr Shapiro's team is interested in applications where direct processing of biological information is needed—such as medicine. In the traditional model of medicine, a doctor takes samples, has these analysed and uses the results to diagnose the presence of a disease. He then administers some kind of treatment. The paradigm that the team is pursuing is *in situ* detection, analysis and treatment of disease. One day, then, a medical computer might be administered as a drug.

At the moment, the computer built by Dr Shapiro's team only works in a watery solution inside a test tube. One worry about taking such work forward is that the insides of a cell are far more complicated and unpredictable than the controlled environment of a test tube. The work, nevertheless, is an important step forward. While it is likely that getting such a computer to function inside a living cell remains some way off, the remarkably rapid progress of biological computers in controlled lab conditions means that that distant day looks to be getting closer.

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Biomechanics

Stumped

Apr 29th 2004 | RAWALPINDI
From The Economist print edition

Technology is throwing the game of cricket into confusion

AP

A matter of degree

HE HAS a normal head, but nestling between his massive shoulders it seems small. He is Shoaib Akhtar, “the Rawalpindi Express”, the fastest recorded bowler of a cricket ball in history. And right now, before a small but baying crowd at the Rawalpindi Cricket Ground, he is steaming towards this (terrified) correspondent. From 22 yards, Mr Akhtar launches into the weirdly beautiful contortion that fast bowlers perform to hurl a six-ounce lump of cork and leather at up to 100mph (161kph). Half a second later, the ball demolishes the stumps.

For over two centuries, cricket has been played according to a largely unwritten code of honour for the practical reason that its laws are too complicated for officials to enforce to the letter. But technology has been rewriting the old etiquette. And according to some recent research, one of cricket's most basic laws is untenable, and now the game is in turmoil.

According to law 24.3, bowlers may not straighten their arm in the final act of delivering the ball. This leads to Mr Akhtar's brutal run-up and elaborate action as alternative means of generating pace on the ball. The centrality of law 24.3 to cricket—and the virtual impossibility of policing it—is reflected in the game's etiquette. To accuse a bowler of throwing the ball is one of the gravest insults in the game; yet now such accusations are flying thick and fast.

Mr Akhtar, the first man to bowl a delivery timed at 100mph, is one of a number of modern stars recently reported with “suspect actions”. These rulings followed research into biomechanics that match officials had hoped would vindicate their decision.

In 2003, a study by Marc Portus, at the Australian Institute of Sport in Canberra, filmed a number of fast bowlers in action using a dozen cameras recording 250 frames per second. They showed that virtually all bowlers straighten their arm, or throw, to some extent. Mr Akhtar flexes his arm more than most only because he is extremely double-jointed. And to confuse matters further, a brilliant Sri Lankan spin bowler, Muttiah Muralitharan bowls with a crooked arm only because a congenital condition prevents him straightening it fully.

In an effort to restore sanity to matters, bowlers are now allowed a varying margin for error depending on the pace at which they bowl. Thus, fast bowlers are legally allowed to straighten their arm by 10°, medium pacers by 7.5° and slow bowlers by 5°. But even this innovation has been rapidly undone.

Last month, for the third time in his illustrious career, and even though poised to break the all-time wicket-taking record, Mr Muralitharan was reported with a suspect action. Though Mr Muralitharan was previously cleared by biomechanics, an English match official questioned the legality of a wicked addition to his armoury of top-spinners, off-spinners and leg-spinners. It is nicknamed the “doosra”, which in Hindi or Urdu means “second” or “other”. Here the ball is delivered with a huge flick of Mr Muralitharan's rubbery wrists and, according to many observers, a flexing of his elbow. Subsequent testing showed that Mr Muralitharan flexes his arm by more than 10° when bowling the doosra, and the delivery could be banned.

Sri Lanka, where Mr Muralitharan is revered, is now seething while many Australians, who have long

reviled him as a “chucker”, are crowing. Should they pause for air, they would hear their own scientists cry foul. Last week, the scientists who tested Mr Muralitharan admitted that they actually did not know much about the mechanics of spin bowling, and that he should receive no censure. When it comes to cricket, science may be stumped.

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About sponsorship

Hitting back

Why globalisation works—and how to make it work better

Apr 29th 2004
From The Economist print edition

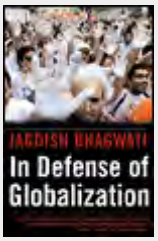
Corbis

An unusually persuasive reply to popular fallacies about global capitalism

ONE thing people in today's rapidly globalising world economy no longer need, you might think, is another book exploring the implications of the rapid globalisation of the world economy. Publishers have churned them out by the dozen in recent years. Can there really be room for yet another? Certainly—and especially so in the case of this new work from the prolific Jagdish Bhagwati of Columbia University.

Up to now, anti-globalist works have had too much the upper hand. They heavily outnumber books advocating or celebrating globalisation. Multiply titles by sales, and their preponderance is overwhelming. Also, one cannot say that globalists have had the lead in quality, at least, or even (as you might suppose) in authors' academic credentials. Many pro-globalisation books are so badly argued, so keen to deploy anecdote not evidence, that they discredit their cause. So far as credentials go, note that anti-globalists would regard Joseph Stiglitz's bestselling "Globalisation and its Discontents", published in 2002 (and none too kindly reviewed in *The Economist* of June 6th that year), as mostly taking their side—and Mr Stiglitz, a Nobel prize-winner, is an undisputed star in the academic and policy firmaments.

In Defence of Globalisation
By Jagdish Bhagwati



Oxford University Press; 320 pages; $28 and £17.99

Buy it at
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Mr Bhagwati's new book, "In Defence of Globalisation", will help to restore the balance—in sales and readers, it is to be hoped, as well as in other ways. Mr Bhagwati has ample reserves of academic eminence: he is a pioneer in trade theory and the author of numerous scholarly works. But what matters more is that he has written an outstandingly effective book—his best popular work to date. Until further notice "In Defence of Globalisation" becomes the standard general-interest reference, the intelligent layman's handbook, on global economic integration.

It has two particular virtues. The first is that it is free of gimmicks in content and structure. Despite coming late to the discussion, it rightly strives for no big new take on the subject, for no grand, previously overlooked and bogus theme around which to organise the material. Its plan is simple and

straightforward.

The core of the book is a series of chapters which look in turn at the charges that anti-globalists make against the international market economy: that globalisation worsens poverty, for instance, that it extends or entrenches the use of child labour, that it worsens the plight of women in developing countries, that it erodes democracy, that it imperils local cultures, that it despoils the environment, and so forth. Each of these claims is then calmly held up to the evidence and shown, as a rule, to be wrong or at any rate dangerously misleading.

Its other great virtue, aside from this refreshingly straightforward approach, is that it takes anti-globalist arguments seriously. More than that, in fact, Mr Bhagwati makes it plain that he shares many of the concerns, and endorses most of the values, that animate the anti-globalist movement. Indeed, if the book has a weakness analytically, it is that Mr Bhagwati is occasionally too generous to his anti-globalist opponents—as when, for instance, he rather uncritically applauds the business-monitoring role that NGOs play in many developing countries. (Sometimes businesses respond to such monitoring, and the possibly ill-advised demands that follow from it, in ways that slow development and therefore hurt the poor.) This posture, on the other hand, makes the book far more persuasive than it would otherwise have been. Mr Bhagwati is as offended by poverty and its indignities as are the anti-globalists. He cannot be accused of complacency. This makes his assault on the anti-globalists' trade-curbing prescriptions far more powerful.

As you might expect, given the thrust of the author's previous academic and policy work, Mr Bhagwati regards liberal trade—the principal driver of globalisation—as essential to raising the incomes and improving the longer-term development prospects of the world's poor. The book is excellent on all the ways in which demands for trade protection, however well intended, lead to bad or unintended consequences that leave the poor worse off. While activist NGOs may have a useful role to play, in Mr Bhagwati's view, that role certainly does not include campaigning for policies that would lead either directly or indirectly to generalised impediments to trade.

“In Defence of Globalisation” is excellent too in insisting that economic integration, while good, is by itself not good enough, and that a variety of steps needs to be taken to enlarge the benefits flowing to the poor. The book offers many suggestions. Balanced, compelling and thorough in its use of evidence, there is much here to make globalists and anti-globalists alike think again, and perhaps even to narrow the differences between them.

In Defence of Globalisation.
By Jagdish Bhagwati.
Oxford University Press; 320 pages; $28 and £17.99

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Four-minute mile

Last of the breed

Apr 29th 2004
From The Economist print edition

ROGER BANNISTER ran the mile in three minutes 59.4 seconds at Oxford University's track at Iffley Road on May 6th 1954, and the 50th anniversary is observed by two well-paced and diligently researched, though quite different, books. One, by a British journalist and accomplished amateur runner (John Bryant), describes Mr Bannister “tapping a deep reserve of pride in Britishness”; the other, by an American (Neal Bascomb) turns the story into an epic contest between the Briton, at medical school in London, Wes Santee, a farm boy working his way through Kansas State University, and John Landy, a student at Melbourne University.

Sir Roger, as he became, was to have a career as a neurologist and master of Pembroke College, Oxford; Mr Landy, an ICI man, became governor of Victoria; Mr Santee runs his own insurance company. But the mile made them famous. Four laps, at an average of 15mph, run in four minutes, required a blend of speed, stamina and endurance. It had a glamour that the Olympic distance, “the metric mile” of 1,500 metres, has never acquired.

Mr Bryant, who is particularly informative about the event's history, finds sketchy evidence from 1785 of a measured mile along the City Road in London run in 3:58 by a professional named Weller. But running, like cricket and horse racing, was organised by gamblers for gamblers, and that era was virtually eradicated from the history of sport by the 19th-century public school and Oxbridge men who believed in the Greek concept of sport as a preparation for life.

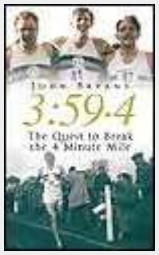
It is easy to see Sir Roger as the last of that breed, and Mr Santee and Mr Landy as the semi-professionals whose bequest was today's astonishing performances by professional athletes. (Although the distance is rarely run at the top class, the mile record is now 3:43.13.) When Sir Roger and his friend Christopher Chataway arrived at Oxford, training too hard was considered boring. Both affected not to do much, but a failure at the 1952 Olympics in Helsinki convinced Sir Roger of the need to work harder. By 1954 both Mr Landy and Mr Santee had come within two seconds of four minutes, and Sir Roger knew he had to run the record early in 1954 if he was to be first. The story of a gale abating just before the start, the exact pacing by his friends, the head-back, eyes-shut finish and his collapse are vividly told in both accounts, though Mr Bascomb's florid narrative suits the race itself better. He manages to turn it into a tear-jerker. Mr Landy beat the record only 46 days later and when he met Sir Roger in August in Vancouver, both ran the mile in less than four minutes.

Sir Christopher (who became a banker and a Tory minister) says his friend's achievement was “the English dream of an amateur beating the world at a time when it was still just possible.”

3:59.4: The Quest to Break the 4 Minute Mile.
By John Bryant.
Hutchinson; 310 pages; £14.99

The Perfect Mile: Three Athletes. One Goal. And Less Than Four Minutes to Achieve It.
By Neal Bascomb.
Houghton Mifflin; 322 pages; $24.

3:59.4: The Quest to Break the 4 Minute Mile
By John Bryant



Hutchinson; 310 pages; £14.99

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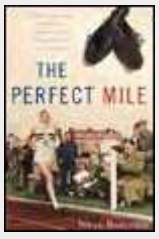

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HarperCollins; £16.99

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California

On the edge

Apr 29th 2004
From The Economist print edition

A GROUP of 19th-century pioneers heading for California became trapped in a blizzard in the Donner Pass of the Sierra mountains. The few survivors ate the frozen cadavers of their colleagues and ploughed onward. Today, Donner is a ski resort. Joan Didion, in her unusual and elegiac memoir of growing up in the Golden State, insists on reminding the reader about the Donner pioneers and how California has evolved in the century and a half since their tragic demise in pursuit of the California dream.

Where I Was From
By Joan Didion

Knopf; 226 pages; $23.
Flamingo; £14.99

Buy it at
Amazon.com
Amazon.co.uk

Anyone who reads this book (out in America for some months but just published in Britain) hoping to find the glamour for which California is famous will be disappointed. “This book”, writes Miss Didion, “represents an exploration into my own confusions about the place and the way in which I grew up, confusions as much about America as about California.” This writer's California is less the stuff that dreams are made on than a place defined by the aspirations of generations of pioneers and immigrants, gold-diggers and coolies who came to the edge of the continent to make a new life.

She probes California's contradictions: its myth of individualism, tolerance, boundless opportunity and non-conformism, tethered to the reality of a state that spends more on its vast prison system than on its university network, paves over ranch land with suburbs, and whose schoolchildren aged nine and ten in 1994 had the lowest literacy rates in the country. Why is it, she asks, that Californians keep moving forward, like the survivors of the Donner party, restless to find the next new thing without ever looking back?

Her answers revolve around her lengthy description of her own family's pioneer history. In her spare prose, citing her grandfather's definition of true Californians as people who kill rattlesnakes when they see them in case they hurt someone else, describing her family's mundane work building irrigation systems and dams to make the drought-ridden Central Valley bloom, she occasionally veers more towards “Little House on the Prairie” than “East of Eden”. But she succeeds in evoking a sense of history about a place usually thought of in the present tense.

As Miss Didion moves from childhood into adulthood, her personal narrative becomes intertwined with the history of her native state and her quest to understand it. In seemingly unconnected episodes drawn from her work as a journalist and her fiction, she examines the micro-culture of California life.

In a famous case, high-school sports stars were accused of raping younger girls and bullying others into silence. How did this perfect world, proud of its “tremendous park and recreation programme” in which men played ball and women supported the teams, spawn such crimes among its middle-class youth? She gets to grips with a town in denial, suburban Lakewood, in southern California. Both the sons and their parents blame everyone else for their woes—the media, the government (what did the government think would happen by providing condoms in schools?), Mexican immigrants who were stealing their jobs.

Lakewood is part of the endless post-war sprawl created by the boom in the federally funded aerospace industry. Miss Didion asks what will become of this suburbia built to supply a now defunct industry? Who will shop in the malls? There seems among everyone she talks to an inability to look at a bigger picture, a fantasist belief that dreams can come true in California, and when they don't it is someone else's fault.

She writes later in the book, “For most of my life California felt rich to me: that was the point of it, that was the promise.” What happens when that promise is not kept? Although Miss Didion never discusses

such grand narratives as elections for governor and recalls, nor does she mention Hollywood, she offers illuminating insights into California's capacity for delusion and reinvention. Before reading this book, some may have wondered how Arnold Schwarzenegger could ever have been elected. After reading it, few will.

Where I Was From.
By Joan Didion.
Knopf; 226 pages; $23.
Flamingo; £14.99

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Hamlet

Enter a youthful Dane

Apr 29th 2004
From The Economist print edition

Trevor Nunn finds a new Shakespearean star

THE theme of youth is to “Hamlet” what love is to “Romeo and Juliet”. Indeed, the words “youth” and “young” run through the text. It is this theme that is daringly explored in a new production by Trevor Nunn at the Old Vic in London. He has cast a fresh-faced 23-year-old unknown, Ben Whishaw, as the tortured prince. This Hamlet could easily pass for a teenager—one in need of a good meal too. Mr Whishaw has until now had only bit parts professionally, including one in the adaptation of Philip Pullman's “His Dark Materials” at the National Theatre. Most of his experience dates back to drama school.

Mr Whishaw's co-stars are similarly green. Jotham Annan, a black actor cast as Horatio, has just graduated from drama school and oozes youthful energy, while Samantha Whittaker, playing Ophelia, is still studying for a degree. Mr Nunn has skipped a generation. Michael Redgrave's Hamlet was 42 and Laurence Olivier's film Hamlet was 41.

This is a “Hamlet” set in the present day. Gertrude is a lady who lunches. Ophelia is a clubber with a taste for loud music, and Horatio wears combats and trainers. Regular “Hamlet” watchers will find the text has been severely shortened: Mr Nunn has seemingly taken note of a modern audience's concentration span.

Does his adventure work? Mr Nunn's production is vital and accessible, qualities that are sometimes obscured by the casting of more august and forbidding theatrical talents, who have been rewarded with the part of Hamlet after years of treading the boards. Mr Whishaw has freshness and energy. With notebook in hand, shirt askew and wearing odd socks, this is very much a modern student prince, self-assured but without arrogance.

The late John Gielgud might well have approved of Mr Nunn's production. He first played Hamlet aged 26 in 1930, and went on to play the part more than 500 times. He said his first Hamlet was the best, because “what one gains with age and experience one often loses in youthful fire and elan”.

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New fiction

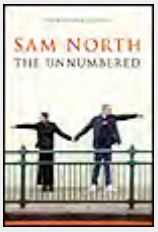
In wasteland London

Apr 29th 2004
From The Economist print edition

ILLEGAL immigration has long awaited its Flaubert; the novelist talented enough to raise the commonplace hopes, fears and desires of displaced humanity into an epiphany. Sam North is that writer.

In his sixth novel, “The Unnumbered”, Mr North travels to parts of London some of us never reach, wasteland gypsy caravans, warm subway tunnels, the mossy extremities of St Pancras cemetery and the cardboard sleeperies of the underpass at Centre Point in the West End. His Londoners have no jobs, no driving licences, no social security numbers, no identity of any sort beyond a single name, a few broken words of English and a past they left behind at Sangatte refugee camp.

The Unnumbered
By Sam North



Scribner; 358 pages; £12.99

Buy it at
Amazon.co.uk

There is Anjali, an Asian girl who trades in the weight of her parents' expectations for the light non-life of an underground down-and-out. Mila, a dark-eyed Romanian 15-year-old, lives with her family in three caravans parked somewhere off the North Circular Road. Mila buys herself an identity and gets a start as a check-out girl at Tesco while she waits for the break that will take her to a higher world. She's going to be a star some day, she can just feel it in the air.

Good and evil are incarnate in the two men who enter the girls' lives. Lucas Tooth, whose assault of Anjali starts her descent into the dossers' underworld, works his charm on the hopeful, the sad, the desperate. But only when Lucas feels their fear does he experience real pleasure. Having destroyed Anjali, who was once a hard-working student, Lucas turns his attention to Mila, the young Romanian girl with the perfect profile.

Mila, though, may have a saviour. Nio Niopolous is 23 and a creative soul. He has built a home in a wood out of scavenged pieces of timber and metal. The roof of his home was once a floor and the floor a roof. A chance encounter with a woman—who has a job and owns her own home—allows Nio to expand his building talent into art. Nio loves Mila and wants to protect her, but are his strength, vision and courage enough to save her from the attention of the wolf, Lucas?

Utterly different from the wine bars and hot dates of Bridget Jones's London, “The Unnumbered” is a breath of fresh air; a rich, complex novel that should be read immediately by everyone who believes in the transporting power of fiction.

The Unnumbered.
By Sam North.
Scribner; 358 pages; £12.99

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Worldwide bestsellers

The big book index

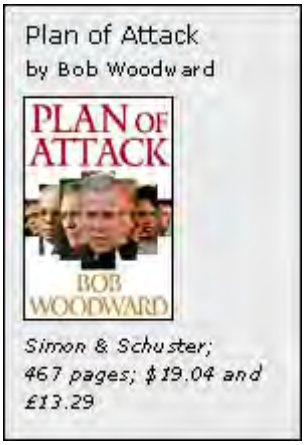
Apr 29th 2004
From The Economist print edition

What really happens in the White House intrigues readers everywhere

BOOKS about decision-making at the highest level make a strong showing in this month's worldwide bestseller rankings. Bob Woodward's "Plan of Attack" enters the list at the top. Richard Clarke's "Against All Enemies" continues to be in demand. For those more concerned with their own weighty matters there is always a new diet book.

Our list is based on information supplied by Amazon, the online book retailer. It draws together its global sales to provide readers of *The Economist* a snapshot of which books are really shifting. Last month's position is in brackets.

1 (0) Plan of Attack



The father-confessor to present and past princes of the White House gets answers to the troubling questions being asked about the decision to invade Iraq. Dick Cheney, the vice-president, is condemned as chief sinner. George Bush and Tony Blair are treated surprisingly mercifully.

Buy from Amazon.com or Amazon.co.uk

2 (0) Eats, Shoots & Leaves: The Zero Tolerance Approach to Punctuation.
By Lynne Truss. *Gotham Books; 240 pages; $12.25. Profile Books; £6.99*

How to deal with apostrophes and other awkward punctuation in the English language. A bestseller in Britain, now tormenting the rest of the world (see article).

Buy from Amazon.com or Amazon.co.uk

3 (2) Against All Enemies: Inside the White House's War on Terror—What Really Happened.
By Richard A. Clarke. *Free Press; 320 pages; $16.20. Simon & Schuster; £13.29*

Mr Clarke, it seems, knew all about the threat of terrorism but could not get his numbskull bosses in the White House to take his warnings seriously.

Buy from Amazon.com or Amazon.co.uk

4 (3) The Da Vinci Code.
By Dan Brown. *Doubleday; 454 pages; $14.97. Corgi Adult; £5.59*

Superior thriller with lots of history and culture to reassure the reader that murder mysteries can be educational too.

Buy from Amazon.com or Amazon.co.uk

5 (0) The South Beach Diet Cookbook: More Than 200 Delicious Recipes That Fit the Nation's Top Diet.
By Arthur Agatston. *Rodale Press; 352 pages; $17.65 and £14*

Try eating cabbage leaves instead of bread. We didn't say slimming was easy.

Buy from Amazon.com

6 (4) Good to Great: Why Some Companies Make the Leap…and Others Don't.
By Jim Collins. *HarperCollins; 320 pages; $19.25. Random House; £14*

Lots of tips about promoting excellence, but no magic bullets. If there were, wouldn't all companies succeed?

Buy from Amazon.com or Amazon.co.uk

7 (5) The South Beach Diet: The Delicious, Doctor-Designed, Foolproof Plan for Fast and Healthy Weight Loss.
By Arthur Agatston. *Rodale Press; 310 pages; $14.97. Headline; £7.69*

One of the must-have bibles for the rich world's overweight. Dr Agatston's cookbook (number 5 on this list) is in demand too.

Buy from Amazon.com

8 (0) Worse Than Watergate: The Secret Presidency of George W. Bush.
By John W. Dean. *Little, Brown; 272 pages; $13.77 and £11.58*

Another look at the not-so-White House by Richard Nixon's lawyer. Mr Dean says George Bush is a lot like Nixon, but not as nice.

Buy from Amazon.com or Amazon.co.uk

9 (1) Harii Pottaa to Fushichoo no kishidan.
By J.K. Rowling. Translated by Yuko Matsuoka. *Say-zan-sha Publications; 2 volumes; ¥4,000*

The Japanese Potter slips down the list. Time for Harry to do some wizardry?

Buy from Amazon.co.jp

10 (0) South Beach Diet Good Fats/Good Carbs Guide: The Complete and Easy Reference for All Your Favorite Foods.
By Arthur Agatston. *Rodale Press; 160 pages; $7.99 and £4.99*

South Beach triumphs again. Is it something in the sand?

Buy from Amazon.com

11 (0) Blind Faith: The Miraculous Journey of Lula Hardaway, Stevie Wonder's Mother.
By Dennis Love and Stacy Brown. *Simon & Schuster; 288 pages; $16.80 and £12.18*

Wonder indeed. How Steveland Judkins, born blind, became a star. All due to Mum, says Stevie.

Buy from Amazon.com or Amazon.co.uk

12 (8) The Purpose-Driven Life: What on Earth Am I Here For?
By Rick Warren. *Zondervan; 336 pages; $11.99 and £7.19*

Discover God in 40 days.

Buy from Amazon.com or Amazon.co.uk

Source: Global orders from Amazon.com, Amazon.co.uk, Amazon.ca, Amazon.fr, Amazon.de and Amazon.co.jp from March 28th-April 24th. Prices quoted from Amazon.com and Amazon.co.uk are correct as of April 27th.

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Estée Lauder

Apr 29th 2004
From The Economist print edition

EPA

Estée Lauder, queen of cosmetics, died on April 24th, at a mature age

A NUMBER of newspapers thought Estée Lauder was 97 when she died. Others averred that she was 95. Most agreed that, until a broken hip slowed her down in 1994, she did not look her age, whatever that was. If anything, the hair had grown blonder and the skin tighter. Outrageous purple outfits, topped by natty hats, reproduced something of the glow of youth.

Subservience to hard facts, such as time and decay, seldom held Mrs Lauder back. Her own background was a study in selective self-improvement. By changing her name, acquiring that dainty little lift of an *accent aigu*, she suggested to customers that her background might be aristocratic and even European. French and Italian blood was hinted at, as well as a convent education. Her father, a monarchist by her telling, felt undressed in the street on Sundays without a cane and gloves.

These details were sprung on the world in 1985, in a book that accompanied the launch of a new perfume, “Beautiful”. For the promotion in Paris, Mrs Lauder had bought up all the pinks in the city to match both the perfume boxes and the book's cover. This sensory extravaganza was designed to eclipse an unauthorised “inside story” of her life. Under covers of cream and blue (so tastelessly passé!) her rival revealed that Mrs Lauder's parents, Hungarian Jews, had run a seed and hardware store in Queens, a run-down borough of New York. The young Estée had probably not finished her studies at Newtown High School. Her first jars of face cream had been cooked up not just in a kitchen over a gas stove, but also in a makeshift lab in a stable, and by an uncle whose chemical experiments stretched not only to “Viennese Cream” but to lice-killer and embalming fluid.

These revelations, about a woman who now counted among her friends Princess Diana, Nancy Reagan, the Gorbachevs and the Begum Aga Khan, were somewhat irritating. Yet it was scarcely a tale to be ashamed of. Young Josephine Esther Mentzer, as she began, was convinced from childhood that women should be beautiful. She also hoped to make a fortune by persuading them that, if they bought her creams, their beauty would last for ever. It is a story, after all, that women tend to need to believe.

With tireless energy, she devoted her life to both causes. She began in the 1930s in the beauty salons of Queens, finding an audience held captive under hairdryers and dabbing their hot cheeks with her uncle's inventions. In 1948, Saks Fifth Avenue took a consignment; it sold out in two days. Steadily, Mrs Lauder acquired shiny counters in more and more department stores. With the help of a friend she branched out in 1953 from creams into Youth-Dew, a bestselling bath oil and perfume combined, and became the

doyenne of all beauty.

Tactility was her byword. She loved to plunge her fingers in her own gently simmering creations, palpating and inhaling them. Her creams came in heavy jars, her lipsticks in cool metal sheaths, to advertise their quality. Whenever she could she smoothed them on customers herself, achieving a “gentle glow” that was immediate and miraculous. For a time, Fifth Avenue was not safe from her. Sales staff at Estée Lauder counters were trained by her to get similarly intimate with customers. Free gifts, then an innovation, were handed out with every purchase, and free samples were sent to aristocrats in Europe. The distinctive Estée Lauder blue-green was devised to harmonise with most rich people's bathrooms. By 2000, more than half of all cosmetics sold in America were hers.

Whether women actually became more beautiful by applying Body Performance Anti-Cellulite Visible Contouring Serum, or whether they would have done as well with a quick douse in cold water, is impossible to say. Clearly, many felt better for it. The very names of these products, energetic and pseudo-scientific, implied that the limits of knowledge had been searched. Mrs Lauder could have cut prices, but refused. Her Crème de la Mer, developed by a NASA scientist, cost $110 for an ounce of vitamins pulped with seaweed. But cheapness, she said, would shake her customers' faith.

Over the decades she became very rich. By this year, her personal fortune stood at $233m and the worth of her company at $5.4 billion, with annual sales of $5 billion in 130 countries. Mrs Lauder was asked to be ambassador to Luxembourg, but declined when her husband said he did not want to carry her bags. Fabulous dinners were arranged, with gifts of Cartier silverware and with the candles set low on the tables to cast a flattering upward light on the *assistance*. The New York gossip columns trailed her obsessively, and still could not find out how old she was.

Time, however, also trailed her, with his ghastly wrinkled face and his sallow hue that co-ordinated with no bathrooms. In 1988 she asked her elder son Leonard, then CEO of the company, to start dyeing his hair, as he was making her look old. That year the company brought in bleached wood and etched glass for its counters, a new blue for its packaging and more androgynous models who glowed with energy and health. Long before the death of the matriarch, Estée Lauder Companies Inc had been gently, but necessarily, moving out of her ageing shadow.

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Overview

Apr 29th 2004
From The Economist print edition

The Conference Board's index of **American** consumer confidence increased by more than expected in April, to 92.9 from 88.5 in March. But confidence may be about to take a knock. As mortgage rates rose to their highest level this year, mortgage refinancing—an important prop to consumer spending—fell again this week. Refinancing is running about 80% below its peak in 2003. The average interest rate on a 30-year mortgage is now more than 6%.

Germany's 12-month rate of consumer-price inflation jumped to 1.6% in April, from 1.1% in March. This was its highest rate in two years, pushed up largely by higher oil prices. **Spain's** producer prices jumped by 0.7% in March, lifting the year-on-year rate of increase to 0.8%.

Italian wages rose by 2.8% in the year to March, a real increase of 0.5% after adjusting for inflation.

Japanese industrial production rose by 7.7% in the year to March—the fastest growth rate in all the countries in the table. However, retail sales fell by 2.3% over the same period. Japan's recovery is still largely being driven by exports, especially to China.

The **euro area's** current-account surplus narrowed to €31 billion ($37 billion or 0.4% of GDP) in the 12 months to February, down from €48 billion a year earlier.

Britain's GDP grew at an annual rate of 2.6% in the first quarter, leaving output 3.0% higher than a year earlier—its strongest growth for almost four years. Retail sales rose by 6.4% in the year to March.

France revised upwards its GDP figures for 2003. They now show output growing at an annual rate of 2.7% in the fourth quarter and up 1.2% over a year earlier. **Belgium** was the first member of the euro area to release its GDP numbers for the first quarter. Output rose at an annual rate of 2.4%, to give growth of 1.9% over the year.

Australian consumer prices jumped by 0.9% in the first quarter, but the annual inflation rate fell to 2.0%, down from 3.4% a year earlier and its lowest rate since 1999.

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Output, demand and jobs

Apr 29th 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 4.0	Q4	+ 5.5	+ 3.9	+ 3.1	– 0.1	Q3	+ 7.3	Q4	5.6	Mar	6.2
Austria	+ 0.8	Q4	+ 0.4	+ 1.6	+ 2.0	+ 3.1	Jan	– 4.8	Jan	4.4	Feb	4.2
Belgium	+ 1.9	Q1	+ 2.4	+ 1.8	+ 2.0	+ 1.2	Feb	+ 0.8	Jan	12.7	Mar†	11.7
Britain	+ 3.0	Q1	+ 2.6	+ 3.2	+ 2.6	– 1.3	Feb	+ 6.4	Mar	4.8	Feb††	5.1
Canada	+ 1.6	Q4	+ 3.8	+ 2.8	+ 3.3	+ 0.5	Jan	+ 1.1	Jan	7.5	Mar	7.4
Denmark	+ 1.0	Q4	+ 2.4	+ 1.8	+ 2.2	– 1.0	Feb	+ 5.3	Feb	6.4	Mar	5.7
France	+ 1.2	Q4	+ 2.7	+ 1.8	+ 2.1	+ 0.9	Feb	+ 2.2	Feb	9.8	Feb	9.4
Germany	+ 0.2	Q4	+ 0.9	+ 1.4	+ 1.7	+ 1.8	Feb	– 1.5	Feb	10.4	Mar§	10.6
Italy	+ 0.1	Q4	nil	+ 1.1	+ 1.8	+ 0.2	Feb	– 0.7	Jan	8.5	Jan	8.9
Japan	+ 3.4	Q4	+ 6.4	+ 3.2	+ 2.0	+ 7.7	Mar	+ 0.9	Feb	5.0	Feb	5.3
Netherlands	– 0.4	Q4	+ 1.7	+ 0.9	+ 1.7	– 2.0	Feb	– 3.0	Jan‡	6.4	Mar**	4.7
Spain	+ 2.7	Q4	+ 3.0	+ 2.8	+ 2.9	+ 2.0	Feb	+ 4.4	Feb	11.2	Feb	11.4
Sweden	+ 1.9	Q4	+ 2.2	+ 2.4	+ 2.4	+ 6.2	Feb	+ 5.3	Mar	5.8	Mar†	4.6
Switzerland	nil	Q4	+ 1.8	+ 1.6	+ 1.8	+ 1.7	Q4	+ 3.7	Feb	4.1	Mar†	3.6
United States	+ 4.3	Q4	+ 4.1	+ 4.7	+ 3.6	+ 3.4	Mar	+ 9.1	Feb	5.7	Mar	5.8
Euro area	+ 0.6	Q4	+ 1.2	+ 1.6	+ 2.0	+ 0.6	Feb	+ 0.5	Feb	8.8	Feb	8.7
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 1.6	Q4	+ 1.1	na	na	– 3.2	Feb	+ 3.6	Feb	9.5	Mar†	9.9
Greece	+ 5.0	Q4	na	na	na	+ 2.5	Feb	+ 1.3	Dec	na		na
Iceland	+ 4.9	Q4	na	na	na	– 0.3	2002	na		3.6	Feb†	4.1
Ireland	+ 2.7	Q4	na	na	na	+ 3.4	Feb	+ 2.6	Feb	4.6	Mar	4.3
Luxembourg	+ 1.3	2002	na	na	na	– 1.2	Dec	+ 4.1	Nov	4.4	Feb	3.8
New Zealand	+ 3.2	Q4	+ 2.4	na	na	+ 3.2	Q4	+ 6.0	Q4	4.6	Q4	4.9
Norway	+ 0.5	Q4	+ 2.4	na	na	+ 0.2	Feb	+ 2.6	Feb	4.2	Q4	3.7
Portugal	– 0.5	Q4	– 1.0	na	na	– 4.5	Feb	+ 0.6	Feb	6.6	Q4†	6.2

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Dec-Feb; claimant count rate 2.9% in Mar. §EU harmonised rate 9.3% in Mar. **Jan-Mar.

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Prices and wages

Apr 29th 2004
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.0	Q1	+ 3.4	+ 2.2	+ 2.6	– 1.1	Q1	+ 3.0	+ 5.9	Q4	+ 3.9
Austria	+ 1.6	Mar	+ 1.8	+ 1.2	+ 1.3	+ 3.0	Mar	+ 2.0	+ 2.1	Mar	+ 2.2
Belgium	+ 1.1	Mar	+ 1.8	+ 1.4	+ 1.5	+ 2.2	Mar	+ 0.8	+ 1.9	Q1	+ 2.4
Britain	+ 1.1	Mar*	+ 1.6	+ 1.5	+ 1.8	+ 1.3	Mar	+ 2.1	+ 3.8	Feb	+ 3.1
Canada	+ 0.7	Mar	+ 4.3	+ 1.5	+ 2.0	– 2.5	Feb	+ 2.8	+ 4.0	Jan	+ 1.8
Denmark	+ 0.7	Mar	+ 2.9	+ 1.4	+ 2.0	+ 0.3	Mar	+ 0.7	+ 3.7	Q4	+ 3.9
France	+ 1.7	Mar	+ 2.6	+ 1.8	+ 1.6	– 0.1	Feb	+ 2.2	+ 2.7	Q4	+ 3.5
Germany	+ 1.6	Apr	+ 1.0	+ 1.1	+ 1.1	+ 0.8	Mar	+ 1.3	+ 1.9	Feb	+ 2.4
Italy	+ 2.3	Mar	+ 2.7	+ 2.1	+ 2.1	+ 0.6	Mar	+ 2.8	+ 2.8	Mar	+ 1.7
Japan	nil	Feb	– 0.2	– 0.2	nil	+ 0.2	Mar	– 0.8	+ 2.0	Feb	+ 1.9
Netherlands	+ 1.1	Mar	+ 2.4	+ 1.4	+ 1.3	+ 0.6	Dec	+ 4.2	+ 1.8	Mar	+ 3.2
Spain	+ 2.1	Mar	+ 3.7	+ 2.3	+ 2.4	+ 0.8	Mar	+ 3.0	+ 3.3	Q4	+ 3.9
Sweden	– 0.1	Mar	+ 3.1	+ 0.9	+ 1.7	– 1.4	Mar	+ 0.6	+ 2.7	Dec	+ 4.0
Switzerland	– 0.1	Mar	+ 1.3	+ 0.4	+ 0.8	– 0.1	Mar	+ 0.3	+ 1.8	2002	+ 2.5
United States	+ 1.7	Mar	+ 3.0	+ 1.8	+ 1.8	+ 2.1	Feb	+ 3.3	+ 1.8	Mar	+ 3.2
Euro area	+ 1.7	Mar	+ 2.4	+ 1.7	+ 1.6	nil	Feb	+ 2.6	+ 2.5	Q4	+ 3.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	– 0.5	Mar	+ 1.6	na	na	– 0.6	Mar	+ 1.3	+ 3.7	Q4	+ 4.1
Greece	+ 2.7	Mar	+ 4.1	na	na	+ 1.4	Feb	+ 2.7	na		na
Iceland	+ 2.2	Apr	+ 2.3	na	na	+ 2.7	Apr	+ 3.2	+ 3.3	Feb	+ 5.6
Ireland	+ 1.3	Mar	+ 4.9	na	na	– 5.1	Mar	– 7.1	+ 6.1	Q4	+ 6.4
Luxembourg	+ 1.8	Mar	+ 2.7	na	na	+ 0.1	Dec	+ 1.3	– 0.4	Dec	+ 0.7
New Zealand	+ 1.5	Q1	+ 2.5	na	na	– 0.1	Q4	– 1.4	+ 2.3	Q4	+ 2.1
Norway	– 0.6	Mar	+ 3.7	na	na	– 1.1	Mar	+ 9.8	+ 3.9	Q4	+ 5.2
Portugal	+ 2.3	Mar	+ 3.9	na	na	+ 0.3	Mar	+ 2.1	+ 0.8	Feb	– 0.4

*New series. RPI inflation rate in March: 2.6%.

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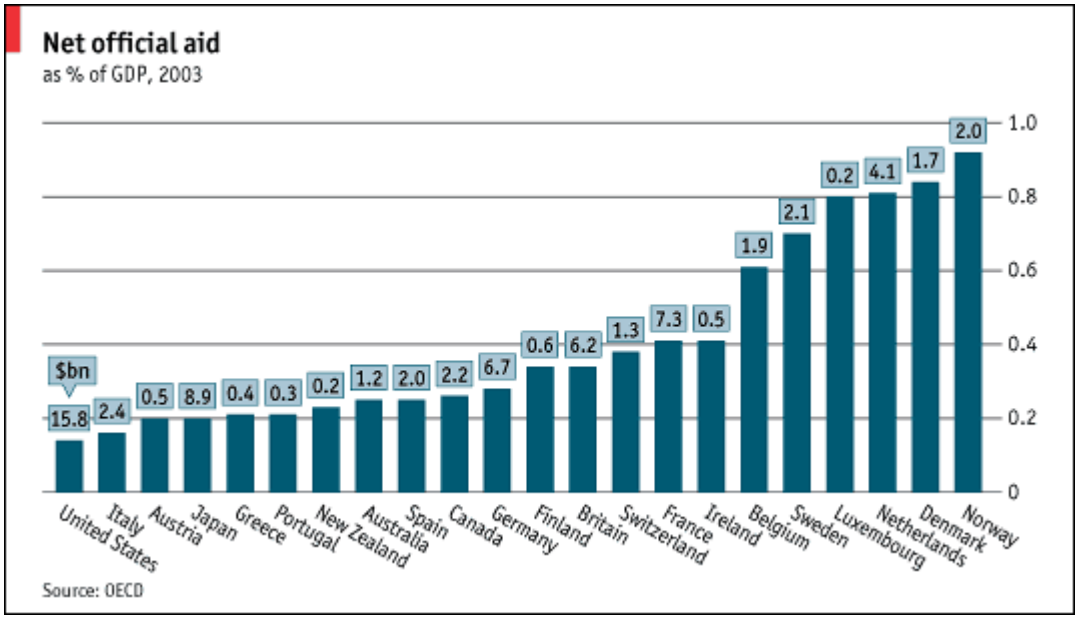
Net official aid

Apr 29th 2004
From The Economist print edition



The rich-country members of the OECD'S Development Assistance Committee increased their official foreign aid by 3.9% in real terms in 2003, to $68.5 billion. That represents 0.25% of their combined GDP, an increase from 0.23% in 2002, but still well below the 0.7% target set by the United Nations. In dollar terms, America is the world's largest donor ($15.8 billion in 2003), but as a share of GDP, its aid budget is the smallest.

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Money and interest rates

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From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Apr 28th 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+10.6	+14.0	Feb	5.54	4.82	5.31	5.84	5.28	6.68
Britain	+ 6.8	+ 8.2	Feb	4.38	3.59	4.56	5.00	4.33	5.80
Canada	+11.6	+ 8.9	Mar	1.95	3.22	2.84	4.66	4.98	6.13
Denmark	+ 6.2	+ 6.6	Feb	2.12	2.73	2.52	4.32	4.29	5.35
Japan	+ 4.1	+ 1.9	Mar	0.02	0.02	0.11	1.52	0.60	1.60
Sweden	+ 1.0	+ 4.2	Feb	2.01	3.43	2.83	4.57	4.59	2.97
Switzerland	+11.6	+ 5.1	Mar	0.29	0.31	1.17	2.71	2.49	2.49
United States	+ 7.5	+ 4.5	Mar	1.06	1.21	2.22	4.46	3.85	5.91
Euro area†	+10.7	+ 6.3	Feb	2.06	2.53	2.43	4.14	4.06	3.94

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.26%, Japan No. 259 1.53%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.0%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Apr 29th 2004
From The Economist print edition

1995=100

	Apr 20th	Apr 27th*	% change on one month	% change on one year
Dollar index				
All items	99.5	98.3	– 1.5	+30.0
Food	96.6	97.1	– 1.1	+24.1
Industrials				
All	103.4	100.0	– 2.1	+38.6
Nfa†	97.0	97.8	+ 1.1	+29.4
Metals	108.8	101.8	– 4.5	+47.1
Sterling index				
All items	87.5	86.7	+ 0.5	+15.5
Euro index				
All items	109.7	108.6	+ 0.8	+20.3
Yen index				
All items	114.6	114.7	+ 2.2	+18.7
Gold				
$ per oz	398.05	396.25	– 5.8	+18.6
West Texas Intermediate				
$ per barrel	37.21	37.49	+ 3.6	+48.5

* Provisional. † Non-food agriculturals.

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Stockmarkets

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From The Economist print edition

Market indices

	Apr 28th	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,450.4	3,462.9	3,274.9	+ 0.2	– 0.4	+ 4.4	+ 0.2
Austria (ATX)	1,963.9	1,985.9	1,568.9	– 0.1	– 1.1	+27.1	+19.3
Belgium (Bel 20)	2,463.4	2,517.3	2,244.2	– 1.1	–33.1	+ 9.8	+ 3.1
Britain (FTSE 100)	4,524.5	4,575.7	4,309.4	– 0.3	–34.7	+ 1.1	+ 0.2
Canada (Toronto Composite)	8,247.3	8,898.8	8,220.9	– 3.8	–27.6	+ 0.3	– 5.1
Denmark (KBX)	229.0	241.3	219.0	– 1.3	–24.1	+ 7.2	+ 0.8
France (SBF 250)	2,549.2	2,594.4	2,411.5	– 0.1	–41.9	+ 5.7	– 0.7
(CAC 40)	3,722.6	3,811.4	3,518.5	– 0.5	–46.2	+ 4.6	– 1.8
Germany (DAX)	4,065.7	4,151.8	3,726.1	+ 1.0	–49.6	+ 2.5	– 3.7
Italy (BCI)	1,333.7	1,340.3	1,239.5	+ 0.6	–38.9	+ 6.1	– 0.3
Japan (Nikkei 225)	12,004.3	12,163.9	10,365.4	+ 0.5	–69.2	+12.4	+ 9.8
(Topix)	1,206.9	1,217.9	1,022.6	+ 0.3	–58.2	+15.6	+12.9
Netherlands (AEX)	347.9	364.8	326.3	– 1.7	–50.4	+ 3.0	– 3.2
Spain (Madrid SE)	864.6	881.7	808.3	– 0.3	–24.6	+ 7.0	+ 0.5
Sweden (Affarsvarlden Gen)	206.3	218.1	188.5	– 2.2	–48.5	+ 9.5	+ 2.4
Switzerland (Swiss Market)	5,792.9	5,934.4	5,469.0	nil	–31.1	+ 5.6	– 0.2
United States (DJIA)	10,342.6	10,737.7	10,048.2	+ 0.2	–11.8	– 1.1	– 1.1
(S&P 500)	1,122.4	1,157.8	1,091.3	– 0.2	–26.5	+ 0.9	+ 0.9
(NASDAQ Comp)	1,989.5	2,153.8	1,901.8	– 0.3	–60.6	– 0.7	– 0.7
Europe (FTSE Eurotop 300)*	1,010.4	1,026.2	957.9	– 0.2	–40.7	+ 5.5	– 1.0
Euro area (FTSE Ebloc 100)*	859.5	888.3	815.4	– 0.4	–44.6	+ 3.3	– 3.0
World (MSCI)†	1,048.3	1,085.8	1,025.9	– 0.4	–27.6	+ 1.2	+ 1.2
World bond market (Citigroup)‡	586.4	619.5	586.4	– 0.3	– 5.3	– 2.9	– 2.9

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Apr 29th 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2004	2005	Exchange rate trade-weighted† 1990=100 Apr 28th	year ago	Currency units per $ Apr 28th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2004‡
Australia	− 15.9	Feb	− 30.0	Q4	− 5.2	− 4.6	86.7	79.6	1.38	1.60	2.45	1.64	1.26	0.5
Austria	− 1.1	Jan	− 1.9	Feb	− 0.3	− 0.5	103.4§	101.9	0.84	0.90	1.50	–	0.77	-1.2
Belgium	+ 20.8	Feb	+ 8.0	Dec	+ 4.2	+ 4.1	103.6§	101.8	0.84	0.90	1.50	–	0.77	nil
Britain	− 82.4	Feb	− 30.8	Q4	− 2.5	− 2.6	104.7	99.2	0.56	0.63	–	0.67	0.51	-2.9
Canada	+ 44.4	Feb	+ 18.5	Q4	+ 1.6	+ 1.1	84.7	81.8	1.37	1.43	2.42	1.62	1.24	0.7
Denmark	+ 9.3	Feb	+ 6.3	Feb	+ 2.7	+ 2.7	105.8	105.9	6.28	6.66	11.1	7.44	5.72	1.0
France	+ 2.9	Feb	+ 11.4	Feb	+ 1.2	+ 1.0	107.3§	104.9	0.84	0.90	1.50	–	0.77	-3.7
Germany	+156.7	Feb	+ 55.8	Feb	+ 2.4	+ 2.3	105.1§	102.2	0.84	0.90	1.50	–	0.77	-3.7
Italy	+ 1.2	Jan	− 19.0	Feb	− 1.0	− 1.0	76.5§	74.8	0.84	0.90	1.50	–	0.77	-2.9
Japan	+116.1	Mar	+149.9	Feb	+ 3.2	+ 3.2	135.9	129.0	110	119	195	130	–	-6.8
Netherlands	+ 32.0	Feb	+ 14.4	Q4	+ 2.8	+ 3.0	103.2§	101.1	0.84	0.90	1.50	–	0.77	-2.5
Spain	− 53.5	Jan	− 23.8	Jan	− 2.8	− 2.7	77.5§	76.2	0.84	0.90	1.50	–	0.77	0.2
Sweden	+ 20.7	Mar	+ 18.9	Q4	+ 5.6	+ 5.3	80.8	80.5	7.70	8.18	13.7	9.12	7.01	0.5
Switzerland	+ 7.7	Mar	+ 32.9	Q4	+10.3	+10.1	111.3	113.9	1.31	1.36	2.32	1.55	1.19	na
United States	−556.5	Feb	−540.9	Q4	− 5.1	− 5.0	98.8	105.8	–	–	1.77	1.18	0.91	-5.1
Euro area	+ 88.2	Feb	+ 37.2	Feb	+ 0.5	+ 0.4	89.2	89.0	0.84	0.90	1.50	–	0.77	-2.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 14.2	Feb	+ 10.4	Feb	na	na	82.7§	80.7	0.84	0.90	1.49	–	0.77	1.9
Greece	− 26.3	Feb	− 11.2	Feb	na	na	59.9§	58.9	0.84	0.90	1.49	–	0.77	-1.6
Iceland	− 0.3	Feb	− 0.6	Q4	na	na	93.1**	94.2	74.0	75.2	131	87.6	67.4	0.2
Ireland	+ 39.8	Jan	− 3.0	Q4	na	na	95.2§	92.4	0.84	0.90	1.49	–	0.77	-1.3
Luxembourg	− 3.5	Jan	+ 2.5	Q4	na	na	103.6§	101.8	0.84	0.90	1.49	–	0.77	-1.8
New Zealand	− 2.3	Mar	− 3.5	Q4	na	na	100.0	96.6	1.61	1.79	2.86	1.91	1.47	2.2
Norway	+ 27.9	Mar	+ 29.7	Feb	na	na	97.6	102.4	6.91	7.00	12.3	8.18	6.30	9.7
Portugal	− 13.9	Jan	− 8.0	Jan	na	na	94.7**	91.7	0.84	0.90	1.49	–	0.77	-3.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, February average. ‡OECD forecast.
**IMF, December average.

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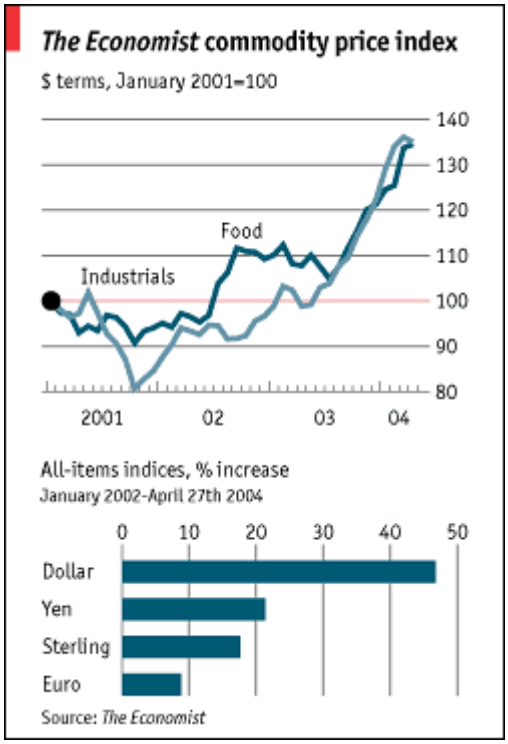
About sponsorship

The Economist commodity price index chart

Apr 29th 2004
From The Economist print edition



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Overview

Apr 29th 2004
From The Economist print edition

Argentina's recovery continues. Industrial output rose by 12.4% in the year to March. Output also increased in neighbouring **Chile,** by 7.8% over the same period.

In Asia the record was more mixed. **Malaysia's** industrial output rose by 11.1% in the year to February. But it was flat in the **Philippines** over the same period. And in **Singapore** it increased by only 2% in the 12 months to March.

Turkey ran a current-account deficit of $783m in January, raising the 12-month deficit to $7.2 billion.

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E-readiness

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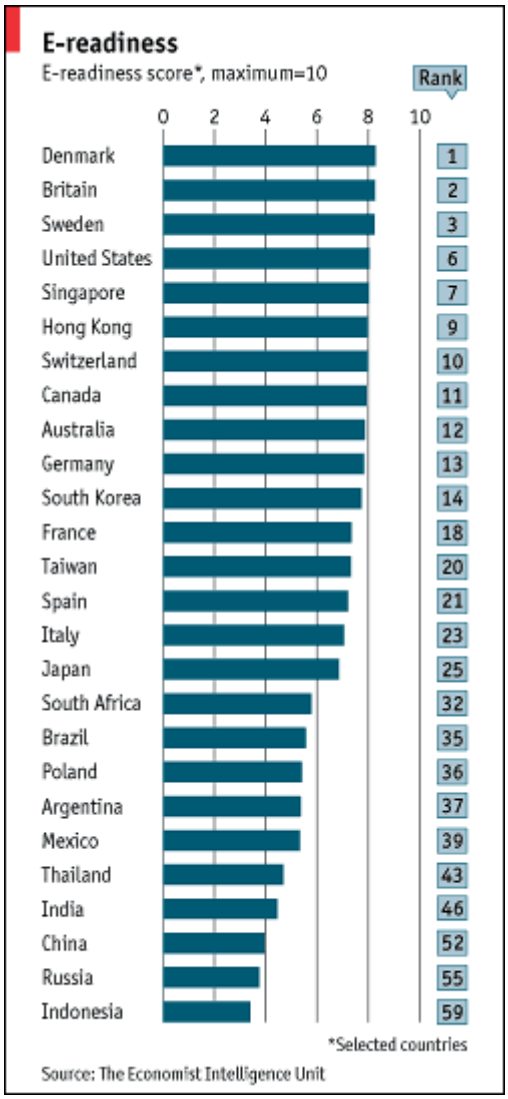
Every year the Economist Intelligence Unit, a sister organisation of *The Economist*, publishes its "e-readiness" ranking of the world's 60 largest economies. This tries to measure a country's e-business environment, taking account of various factors that indicate how amenable a market is to internet-based opportunities. These include broadband and mobile-phone penetration, as well as regulation and other features. Denmark tops the league; indeed, four of the top five countries are Scandinavian. Britain is ranked second. America, surprisingly, is only in sixth place.



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Economy

Apr 29th 2004
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.7	Q1	+23.2	Feb	+ 3.0	Mar	+18.0	Mar	+35.4	2002	439.8	Mar
Hong Kong	+ 5.0	Q4	– 6.1	Q4	– 2.1	Mar	–10.3	Mar	+17.4	Q4	123.8	Mar
India	+10.4	Q4	+ 7.4	Feb	+ 4.1	Feb	–15.4	Mar	+ 3.2	Q4	106.1	Mar
Indonesia	+ 4.4	Q4	+ 5.1	Jan	+ 5.1	Mar	+28.7	Feb	+ 7.8	Q3	34.8	Feb
Malaysia	+ 6.4	Q4	+11.1	Feb	+ 1.0	Mar	+21.1	Feb	+12.3	Q4	48.3	Feb
Philippines	+ 4.5	Q4	nil	Feb	+ 3.8	Mar	– 1.8	Feb	+ 3.3	Dec	13.0	Mar
Singapore	+ 7.3	Q1	+ 2.0	Mar	+ 1.3	Mar	+15.7	Mar	+28.2	Q4	102.7	Mar
South Korea	+ 3.9	Q4	+11.6	Mar	+ 3.1	Mar	+24.0	Mar	+20.4	Mar	163.6	Mar
Taiwan	+ 5.2	Q4	+15.7	Mar	+ 0.9	Mar	+15.3	Mar	+28.6	Q4	226.5	Mar
Thailand	+ 7.8	Q4	+16.4	Feb	+ 2.3	Mar	+ 3.4	Mar	+ 7.9	Feb	41.9	Feb
Argentina	+11.3	Q4	+12.4	Mar	+ 2.3	Mar	+14.5	Feb	+ 7.9	Q4	14.9	Mar
Brazil	– 0.1	Q4	+ 1.8	Feb	+ 5.9	Mar	+27.2	Mar	+ 5.7	Mar	52.5	Feb
Chile	+ 3.3	Q4	+ 7.8	Mar	– 0.7	Mar	+ 4.2	Mar	– 0.6	Q4	15.9	Mar
Colombia	+ 4.3	Q4	+ 3.6	Dec	+ 6.2	Mar	+ 0.3	Jan	– 1.4	Q4	11.3	Mar
Mexico	+ 2.0	Q4	+ 2.2	Feb	+ 4.2	Mar	– 6.0	Mar	– 9.2	Q4	63.1	Feb
Peru	+ 4.1	Feb	+ 2.2	Feb	+ 2.8	Mar	+ 1.0	Feb	– 1.1	Q4	9.8	Feb
Venezuela	+ 9.0	Q4	+100.4	Jan	+23.6	Mar	+15.0	Q4	+ 9.6	Q4	17.2	Feb
Egypt	+ 3.1	2003†	+ 2.6	2003†	+ 5.5	Dec	– 6.0	Q4†	+ 3.9	Q4†	13.6	Feb
Israel	– 0.6	Q4	+ 8.8	Feb	– 2.7	Mar	– 5.7	Mar	– 0.2	Q4	26.6	Mar
South Africa	+ 1.5	Q4	– 1.4	Dec	+ 0.4	Mar	+ 1.9	Feb	– 1.5	Q4	8.3	Mar
Turkey	+ 6.1	Q4	+15.6	Feb	+11.8	Mar	–22.5	Jan	– 7.2	Jan	33.3	Feb
Czech Republic	+ 3.1	Q4	+ 7.1	Feb	+ 2.5	Mar	– 2.4	Mar	– 5.7	Q4	27.0	Mar
Hungary	+ 3.6	Q4	+12.3	Feb	+ 6.7	Mar	– 3.7	Feb	– 6.0	Feb	12.3	Mar
Poland	+ 4.7	Q4	+23.8	Mar	+ 1.7	Mar	– 5.3	Feb	– 3.7	Feb	35.3	Mar
Russia	+ 6.2	Q3	+ 6.6	Mar	+10.3	Mar	+63.0	Feb	+35.3	Q1	79.6	Mar
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 5.7	Q4	+ 5.2	Mar	+ 0.4	Mar	– 2.0	Feb	– 1.2	Q4	1.3	Feb
Latvia	+ 7.4	Q4	+ 8.5	Feb	+ 4.8	Mar	– 2.1	Feb	– 1.0	Feb	1.4	Feb
Lithuania	+ 7.5	Q1	na		– 1.0	Mar	– 2.8	Feb	– 1.2	Q4	3.2	Feb
Slovakia	+ 4.7	Q4	+ 7.8	Feb	+ 8.2	Mar	– 0.5	Feb	nil	Feb	12.3	Feb
Slovenia	+ 2.5	Q4	– 0.2	Feb	+ 3.5	Mar	– 0.8	Feb‡	nil	Feb	8.6	Jan
Pakistan	+ 5.1	2003†	–13.3	Dec	+ 5.3	Mar	– 1.6	Mar	+ 3.6	Q4†	11.4	Feb
Saudi Arabia	+ 1.0	2002	na		+ 0.4	Feb	+42.6	2002	+11.9	2002	23.9	Jan

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Apr 29th 2004
From The Economist print edition

	Currency units per $ Apr 28th	Currency units per $ year ago	Currency units per £ Apr 28th	Interest rates short-term % p.a.	Stockmarkets Apr 28th	% change on one week	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
China	8.28	8.28	14.7	2.90	1,684.8	– 2.7	+ 7.4	+ 7.4
Hong Kong	7.80	7.80	13.8	0.21	12,165.3	– 0.5	– 3.3	– 3.7
India	44.1	47.3	78.3	4.37	5,713.1	– 2.8	– 2.2	+ 1.2
Indonesia	8,641	8,674	15,332	7.53	817.9	+ 0.5	+ 18.2	+ 15.2
Malaysia	3.80	3.80	6.74	3.03	861.6	– 0.3	+ 8.5	+ 8.5
Philippines	55.7	52.5	98.9	7.88	1,610.3	+ 4.7	+ 11.6	+ 11.2
Singapore	1.70	1.78	3.01	0.75	1,847.8	nil	+ 4.7	+ 4.9
South Korea	1,157	1,215	2,052	3.90	901.8	– 3.0	+ 11.2	+ 14.6
Taiwan	33.0	34.8	58.5	1.10	6,574.8	– 3.5	+ 11.6	+ 15.0
Thailand	39.8	42.9	70.6	1.30	672.3	– 4.9	– 12.9	– 13.3
Argentina	2.85	2.83	5.05	2.69	1,133.2	+ 4.5	+ 5.7	+ 8.8
Brazil	2.93	2.89	5.20	15.85	20,473.6	– 2.9	– 7.9	– 9.4
Chile	623	705	1,105	1.68	7,389.0	+ 1.1	+ 0.7	– 4.1
Colombia	2,633	2,867	4,672	7.85	3,441.3	+ 3.2	+ 47.5	+ 55.7
Mexico	11.3	10.3	20.1	6.00	10,240.9	– 2.8	+ 16.4	+ 15.5
Peru	3.48	3.46	6.18	2.52	2,862.3	– 3.7	+ 17.5	+ 16.9
Venezuela	2,942§	1,598	5,220	15.62	25,703.1	– 0.6	+ 15.8	+ 12.2
Egypt	6.18	5.94	10.96	8.49	15,503.5	+ 1.2	+ 33.2	+ 33.0
Israel	4.60	4.55	8.17	1.00	579.4	– 0.7	+ 8.4	+ 3.5
South Africa	6.85	7.30	12.1	8.20	10,611.5	– 0.4	+ 2.2	– 0.4
Turkey	1,428,400	1,566,000	2,534,553	20.00	18,229.7	– 5.4	– 2.1	– 3.7
Czech Republic	27.7	28.2	49.1	2.06	850.4	+ 0.4	+ 29.0	+ 19.6
Hungary	212	220	377	11.77	11,231.3	– 3.2	+ 19.7	+ 16.9
Poland	4.03	3.81	7.15	5.75	24,601.6	– 2.2	+ 18.2	+ 9.7
Russia	28.9	31.1	51.2	14.00	670.5‡	– 3.7	+ 16.7	+ 18.2
EMF (MSCI)*	1.00	1.00	1.77	na	463.2	– 2.9	+ 4.6	+ 4.6
EMBI+†	1.00	1.00	1.77	na	286.5	– 1.8	– 2.8	– 2.8

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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